

2 UNITED STATES BANKRUPTCY COURT  
3 SOUTHERN DISTRICT OF NEW YORK

4 -----x

5 In the Matter

6 of

Case No.

03-13057

7 ALLEGAINCE TELECOM, INC.,

8 Debtors.  
9 -----x

10  
11 November 7, 2003

12 United States Custom House

13 One Bowling Green

14 New York, New York 10004

15 Application to Employ KPMG LLP as  
16 Accountants, Auditors, Tax Advisors and Bankruptcy  
17 Compliance Advisors; Debtors Motion to Reject  
18 Certain Unexpired Leases, Certain Individual  
19 Service Orders, and Certain Executory Contracts.  
20

21 B E F O R E:

22  
23 HON. ROBERT D. DRAIN,

24  
25 U.S. Bankruptcy Judge.

## 2 A P P E A R A N C E S:

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2 P R O C E E D I N G S :

3 THE COURT: Allegiance.

4 MR. HENES: Good morning, your  
5 Honor. Johns Henes of Kirkland and Ellis on behalf  
6 of the debtors.

7 THE COURT: Good morning.

8 MR. HENES: Your Honor, I'd like to  
9 just go through the agenda as it is. I know at the  
10 end of the hearing, Ms. Plaskon, on behalf of the  
11 prepetition lenders, and Mr. Dublin on behalf of  
12 the committee may have something to say.

13 THE COURT: Okay.

14 MR. HENES: I just want to give you  
15 an update on our progress, which, when I go through  
16 the KERP motion you'll get a lot of that.

17 THE COURT: Okay. I had a feeling I  
18 would.

19 MR. HENES: Your Honor, as you know,  
20 we filed the original KERP motion on August 11th;  
21 and since that time we have gotten approval of the  
22 majority of the key employees retention programs.  
23 What's left are the 6 top executives, as well as  
24 Larry Strickling, who is one of the in-house  
25 counsel, and Deborah Surette, who was actually

2 terminated by the debtor without cause, and finally  
3 Sanjeev Sethi, who is in the finance group.

4           Your Honor, once we filed the  
5 initial motion, there was a significant amount of  
6 negotiations with the prepetition lenders and the  
7 creditors' committee regarding, most specifically,  
8 the six top executives and what would be the proper  
9 retention payments for them. At the same time we  
10 were negotiating that, we were also negotiating  
11 with the prepetition lenders regarding the stand  
12 alone structure. And we are in agreement with the  
13 prepetition lenders, and today still agree with  
14 them, on the terms of the stand alone; however, in  
15 the meantime we had started to get indications of  
16 interest from third parties seeking to potentially  
17 buy substantially all of the debtor's businesses.  
18 And so what we did was, in consultation with the  
19 lenders and the committee, we began to talk to a  
20 number of those parties. And actually, currently  
21 we are negotiating with two parties, a potential  
22 stalking horse asset purchase agreement. Because  
23 of the change in circumstances and because now  
24 whether the stand alone plan is going to act as a  
25 stalking horse or whether we actually enter into a

2 stalking horse agreement, it doesn't look like we  
3 are going to have an auction here, which leads to  
4 uncertainty for the top six executives about their  
5 employment. And this is uncertainty at a time when  
6 we really need them the most, because we need to  
7 get through this process and we need to make sure  
8 that they stay throughout.

9           As a result, we have reached a  
10 consensual deal with the lenders and the committee  
11 in terms of a retention program, and it is modified  
12 from the original one. And this is really based on  
13 the distributable value of creditors under our  
14 plan. So, kind of taking the 10 thousand foot view  
15 of it, the remaining six executives could get as  
16 little as 60 percent of the KERP payments, as it  
17 was under the original plan under the new one, but  
18 could potentially get 155 percent or more,  
19 depending on the amount of value that comes into  
20 the estate.

21           We believe, and the debtor and the  
22 Board has done a lot of thinking about this, and I  
23 think the committee and the lenders think this as  
24 well, is that this provides proper incentives to  
25 the remaining six key executives to stay with the

2 company and focus on the best deal for the estate  
3 to bring in the maximum value and without being  
4 concerned with -- not concerned, but with  
5 minimizing the concern for their future employment.

6 The other individuals, your Honor,  
7 that I mentioned, are much more routine and --  
8 well, I take that back. Larry Strickling, we are  
9 just looking to get the final 25 percent, I believe  
10 it is, of his payment -- whatever remaining payment  
11 for him, we are looking to get that approved. And  
12 there's been no objection to that by the committee  
13 or the lenders.

14 THE COURT: Is that changed from --  
15 is his deal changed from what was initially  
16 proposed?

17 MR. HENES: His deal is not changed,  
18 your Honor.

19 THE COURT: Okay.

20 MR. HENES: The only modifications  
21 are that he needs to stay now until confirmation of  
22 a plan. Before he had to stay until December 31st.

23 THE COURT: Okay.

24 MR. HENES: So he would get paid on  
25 December 31st, but he has to remain until the plan

2 is confirmed.

3 THE COURT: Okay.

4 MR. HENES: Deborah Surette, who we  
5 mentioned, was terminated without cause. All we  
6 are seeking approval of today is that the  
7 prepetition amount that she was paid, that that is  
8 approved. She will not get any further payments,  
9 obviously, since she is no longer with the company.

10 THE COURT: Okay. And the  
11 prepetition amount was part of the original  
12 proposal?

13 MR. HENES: That's correct, your  
14 Honor. And then with Sanjeev Sethi, we are  
15 actually looking to have a motion, as it relates to  
16 him, dismissed without prejudice today.

17 THE COURT: Okay. When you say stay  
18 through confirmation of a plan, that includes a  
19 plan that may just be distributing a pot of money  
20 that resulted from a sale?

21 MR. HENES: That is correct, your  
22 Honor.

23 THE COURT: With regard to the other  
24 six senior executives, are the changes to the KERP  
25 that was originally proposed memorialized in

2 writing somewhere?

3 MR. HENES: Well, they are in the  
4 supplement to the motion -- they are in the  
5 supplement to the motion, and in addition, there  
6 are retention agreements, and those retention  
7 agreements we modified.

8 THE COURT: Right. So the  
9 supplement reflects the current deal with the  
10 committee and the lenders?

11 MR. HENES: That's correct, your  
12 Honor.

13 THE COURT: And when was that filed?

14 MR. HENES: That was filed two days  
15 ago, on Wednesday.

16 THE COURT: Okay. And it was served  
17 on the 2002 list?

18 MR. HENES: Yes, your Honor. There  
19 were three individuals who we did not have fax  
20 numbers for, and we tried to find phone numbers and  
21 we could not find them. I'm not even sure if there  
22 are any claims that those parties have, and if  
23 there are, they are not significant. And I will  
24 note that we have received no formal objections to  
25 any of those.



2 THE COURT: And it was served by fax  
3 this Wednesday, this week?

4 MR. HENES: This Wednesday, by  
5 either Fed Ex or fax.

6 THE COURT: Okay.

7 MR. HENES: Your Honor, I could take  
8 you through exactly what we are seeking today, or  
9 if you are ready to --

10 THE COURT: No. I think -- I just  
11 wanted to make sure there weren't any changes from  
12 the supplement.

13 MR. HENES: There have been -- oh,  
14 your Honor. Thank you, Mr. Dublin. There's been  
15 one change. We did request to have the amounts of  
16 prepetition ordinary course salary to the  
17 executives that was above the 4,650 thousand dollar  
18 minimum...

19 THE COURT: Priority.

20 MR. HENES: Thank you. Priority  
21 claim to be paid per the committee. Although it  
22 does not appear that they have an objection to  
23 this, because of the late notice they received,  
24 they need to sit down with the committee early next  
25 week and talk about it.

2 THE COURT: I appreciate that you  
3 have been doing a lot of work on this, and we  
4 obviously need to balance the concerns that the  
5 executives have, and the rest of the company. But  
6 I am a little concerned that, unlike the  
7 modifications to the other three individuals, that  
8 the modifications to these six are improvements, in  
9 some respects, on both earlier notice; and in  
10 effect, there's only be one day's notice. And I'm  
11 wondering if we can note for the record, the  
12 committee and the banks' response on this, which  
13 I'm assuming is, as you said, in support. And then  
14 adjourn the hearing on the matter until next week,  
15 if there are any objections. If there are no  
16 objections, then I would enter an order approving  
17 it, just to give people extra time to review it;  
18 particularly given the fact that, obviously  
19 although the committee and the lenders have by far  
20 the most money at stake in this matter and have  
21 reviewed this carefully, KERP programs for senior  
22 management seems to be a lightning rod in cases  
23 like this, and sometimes raise appearance issues  
24 with creditors. And I'm just a little  
25 uncomfortable approving this on such short notice,

2 unless you tell me that there's a dire emergency  
3 and someone is going to leave if they don't have a  
4 hearing, you know, if they don't know this today as  
5 a result of this hearing.

6 MR. HENES: Can I make one request,  
7 your Honor?

8 THE COURT: Yes.

9 MR. HENES: A little modification to  
10 what you said. Is there any way we could have --  
11 these six executives are very anxious about this  
12 because they have been waiting, and I believe doing  
13 the right thing by getting everybody else's KERPs  
14 through, could we get an order entered basically on  
15 negative notice?

16 THE COURT: Yes. That's what I had  
17 in mind, is a negative notice procedure, so we  
18 wouldn't have to have another hearing unless  
19 someone objected.

20 MR. HENES: That would be fine, your  
21 Honor.

22 THE COURT: Okay. I didn't want to  
23 jump the gun, but that was my concern about this,  
24 based on what you told me. Let me know if you are  
25 right.

2 MR. DUBLIN: Your Honor, Phil Dublin  
3 for the committee. We've been heavily involved in  
4 the negotiations in this modified KERP, with the  
5 debtors, along with counsel for the bank lenders,  
6 believe that, as proposed, this structure for  
7 senior management will probably incentivify them, to  
8 increase value for all constituencies, secured and  
9 unsecured alike, and are in favor of the ruling.

10 MS. PLASKON: Your Honor, Leslie  
11 Plaskon, as counsel for the bank group. We too  
12 support today's court's approval, subject to the  
13 negative notice provisions of the KERP package.  
14 This has been a subject of extensive negotiations  
15 between the lenders committee and the company, and  
16 at this point we are comfortable with its terms.

17 THE COURT: Okay. Well, as I  
18 indicated before, I'm prepared to approve this with  
19 the negative notice procedure that we discussed.  
20 Given the active exploration of a sale alternative  
21 here, I think this is, in some respects, the most  
22 appropriate context for a KERP. It removes any  
23 potential conflict that senior management might  
24 have in exploring other alternatives to a stand  
25 alone plan; and clearly that has been the result of

2 negotiations with the committee and the banks, so  
3 I'm not going to second guess their judgment on  
4 this.

5 MR. HENES: Thank you.

6 THE COURT: So I think you have to  
7 modify the order a little bit, but only to provide  
8 that the order will become effective on the 14th;  
9 provided that there are any objections, we will  
10 have a hearing on the 14th.

11 MR. HENES: Okay. Thank you, your  
12 Honor. We will do that.

13 Your Honor, the rest of the motions  
14 are pretty routine. The next one is the debtor's  
15 application to retain KPMG as their auditors.

16 We filed this application on August  
17 6th, seeking nunc pro tunc relief until July 22nd.  
18 The committee raised some issues and the U.S.  
19 trustee raised some issues. The U.S. trustee and  
20 the committee, working with the debtors and KPMG,  
21 have resolved all of those issues. And there has  
22 been additional disclosures made, there has an  
23 assurance to the committee that there will be no  
24 duplication of efforts between the work of KPMG and  
25 any of the debtor's other professionals. The only

2 significant change is -- it's not that significant,  
3 is that the nunc pro tunc relief should be June 30  
4 instead of July 22nd, that's when KPMG really began  
5 their work. The committee and the U.S. trustee are  
6 on board with that.

7 THE COURT: Okay.

8 MR. ADAMS: Your Honor, good  
9 morning. Colin Adams, with Akin Gump for the  
10 committee. As Mr. Henes stated, we have expressed  
11 our concerns to the debtor. As we've worked  
12 through those, we've had the opportunity to review  
13 the second affidavit that was filed, and we support  
14 the debtor's protection of KPMG according to those  
15 terms.

16 THE COURT: Okay. They are being  
17 paid on an hourly basis, right?

18 MR. ADAMS: That's right.

19 THE COURT: So, obviously everyone  
20 has their right to review that to confirm that  
21 there has been no duplication at the end of the  
22 case.

23 MR. HENES: That's correct, your  
24 Honor.

25 THE COURT: All right. I'll grant

2 the application nunc pro tunc to the June date.

3 MR. HENES: Thank you very much,  
4 your Honor.

5 The next motion, your Honor, is a  
6 motion to reject certain unexpired leases. This  
7 motion was actually on for the October 21st  
8 hearing. At that hearing, you approved the  
9 rejection of one those leases, and as we mentioned  
10 to you, we realized that we inadvertently provided  
11 notice of the motion to the original lessor instead  
12 of GE Capital Corporation and City Group Vendor  
13 Finance who are the lessors under the leases  
14 currently. We have provided notice to those  
15 parties. They do not have any objections. There  
16 was one question by Citicorp, which was they wanted  
17 to make sure that the lease was actually  
18 transferred; this lease was part of a sale in the  
19 business that the debtors bought from WorldCom.  
20 They wanted to make sure that the lease was  
21 actually transferred to the debtors, which it was;  
22 and therefore there were no objections to the  
23 rejection of those two leases, and I seek approval  
24 of that as a matter of the debtor's business  
25 judgment.

2 THE COURT: All right. I'll approve  
3 that motion.

4 MR. HENES: Thank you, your Honor.

5 Your Honor, the next motion is one  
6 that we brought before you numerous times, which is  
7 the rejection of individual service orders that are  
8 for telecommunication services pursuant to tariffs  
9 or other master service agreements with ILECs and  
10 CLECs. The debtors have determined that they don't  
11 need the services under these service orders any  
12 more and would save approximately 209 thousand  
13 dollars annually by rejecting this, and therefore,  
14 as a matter of sound business judgment, they seek  
15 to reject these service orders.

16 THE COURT: And these orders have  
17 the same language that you've been having regarding  
18 the various orders of debtor's business judgement  
19 rights?

20 MR. HENES: Identical, your Honor.

21 THE COURT: Okay. I'll approve that  
22 motion as well.

23 MR. HENES: Thank you.

24 The final motion, your Honor, is  
25 another motion to reject executory contracts and



2 unexpired leases. We are seeking -- the motion  
3 seeks to reject three executory contracts and one  
4 personal property lease; however, we've agreed to  
5 adjourn the hearings until the 19th on one of the  
6 executory contracts, and this is with Davidson  
7 Capital, which is basically a broker that goes out  
8 and looks to find money. We received a call from  
9 Davidson Capital asking if we would adjourn, and  
10 we've agreed to do that.

11 THE COURT: Are they doing anything  
12 to that effect at this moment?

13 MR. HENES: It depends on who you  
14 ask, your Honor. That's one of the reasons for the  
15 adjournment, we need to have some discussions with  
16 them.

17 THE COURT: Well, obviously they  
18 haven't been retained in this case; and I'm not  
19 sure they would need to be.

20 MR. HENES: That's correct, your  
21 Honor.

22 THE COURT: Okay.

23 MR. HENES: Your Honor, the other --  
24 the two contracts, one is for alarm services and  
25 one is for dial-up telephone services. The debtors

2 don't need those services anymore; they've already  
3 rejected the real property leases that those are  
4 related to. And the one personal property leases  
5 is for a copier, again, which the debtors do not  
6 need because they rejected the real property lease  
7 that it's related to. And as a result, your Honor,  
8 the debtors seek approval of the rejection of those  
9 leases.

10 THE COURT: All right. I'll approve  
11 that motion with the one retracted.

12 MR. HENES: Thank you, your Honor.

13 Your Honor, we also have a status  
14 conference today. We can either give you an update  
15 of the case --

16 THE COURT: Well, why don't you give  
17 me the update, because I got a call from the other  
18 party in the adversary proceeding who is going to  
19 appear by phone; so before we hook in, why don't we  
20 have the status update for the Chapter 11 case.

21 MR. HENES: Sure. As I mentioned,  
22 as part of KERP motion, we have been in the process  
23 of talking to a number of parties about a potential  
24 sale of the businesses. We are heavily involved in  
25 negotiations right now with those parties

2 attempting to finalize a stalking horse asset  
3 purchase agreement. We are very far along in that  
4 process; we have been working extremely hard, all  
5 the professionals and the management team, in  
6 attempting to get this done. We've been keeping  
7 the committee and the lenders apprised of the  
8 progress we're making, the process we are on, as  
9 well as providing them with copies of the asset  
10 purchase agreements and the different terms in  
11 those agreements, to make sure they have full  
12 information, which they do.

13 I think, as you could note from this  
14 hearing, although there's been significant  
15 negotiations on the issues between all of the  
16 parties, we are coming to resolutions now, and it  
17 does look to me like we are moving forward very  
18 well, and if not arm and arm, almost arm and arm,  
19 as Mr. Dublin spoke about before the hearing. And  
20 we anticipate in the very near future, either being  
21 able to file a stalking horse asset purchase  
22 agreement, along with a plan, and purchase  
23 agreement and a process for having the sale  
24 consummated pursuant to a plan, or filing a stand  
25 alone plan, which I think would also contemplate an

2 auction. And we are looking -- our board is asking  
3 us to move with urgency, as they want to see  
4 Allegiance emerge from Chapter 11; and we are doing  
5 that.

6 THE COURT: So, under either  
7 alternative, you are contemplating a plan of  
8 process, but a sale may be incorporated into the  
9 plan?

10 MR. HENES: That's correct, your  
11 Honor. If you would like, I can give you an  
12 overview of what we are thinking.

13 THE COURT: No, that's okay.

14 MR. HENES: And with that being  
15 said, I do think there's been substantial progress  
16 being made recently, and I see no reason why that  
17 progress will not be anything but good progress  
18 going forward.

19 THE COURT: Okay. And I think I  
20 entered the stipulation extending exclusivity  
21 yesterday for a couple weeks, I guess.

22 MR. HENES: It's actually -- we've  
23 been doing it rolling, so the exclusivity runs  
24 until you make a final determination on our motion,  
25 which I believe the date we had in the motion is

2 December 15th. I would anticipate that once we  
3 file a plan -- file a supplement to that, and seek  
4 additional time.

5 THE COURT: Are you thinking of --  
6 well, I guess it depends on your negotiations with  
7 the third parties, but you are thinking about  
8 filing something by the 15th?

9 MR. HENES: By December 15th?

10 THE COURT: Yes.

11 MR. HENES: Yes. We would  
12 anticipate that.

13 THE COURT: Okay. Does anyone have  
14 anything to add?

15 MS. PLASKON: Sure. Your Honor,  
16 Leslie Plaskon on behalf of the bank group. We  
17 wanted to provide the court with just a brief  
18 overview as to where we see the progress in this  
19 case; although we agree with Mr. Henes' comments  
20 that the bank group and the debtors have been  
21 working in a very cooperative spirit, and we've  
22 been very encouraged by the progress to date, and  
23 they have been very good at keeping us in the loop  
24 with the strategic alternatives, we do note that --  
25 you know, the case was filed on May 14th. We are

2 just about at the six month mark. The footnote to  
3 that, your Honor, is that we had spent a  
4 significant amount of time pre filing trying to  
5 negotiate a prepackage plan. So to us, this isn't  
6 really a six month mark, it's more of -- it's  
7 almost a year mark.

8 From our perspective, to be more  
9 specific, we have negotiated a stand alone plan  
10 that we are very comfortable with. From our  
11 perspective, we encourage the debtor to continue  
12 its strategic alternatives, but in the event that  
13 they cannot reach resolution in the next few weeks,  
14 we would like to see the stand alone plan filed on  
15 or before November 19th, which is the next hearing  
16 date. Given where we are and the amount of time  
17 we've spent in negotiations, we believe it's the  
18 more appropriate way to move the case along.

19 MR. DUBLIN: Your Honor, I will echo  
20 both of my colleague's comments, that we are happy  
21 with where the process is currently going. We  
22 believe it's moving along now at a speed that's  
23 going to maximize value for the constituencies in  
24 the mere terms that this company can't get out of  
25 bankruptcy. As you probably imagine and expect,

2 the committee is not on board with the stand alone  
3 process that has been negotiated upon the banks and  
4 the company. We do not believe that is the proper  
5 way for this company to move forward to get out of  
6 bankruptcy. We do believe the sale process is  
7 proper and that it will maximize value and that it  
8 should come to conclusion in the near future.

9 THE COURT: Well, obviously -- maybe  
10 not obviously, but maybe counter intuitively, the  
11 bankruptcy does give the debtor some options with  
12 buyers that, at least, a financially distressed  
13 debtor doesn't have pre-bankruptcy. So I think  
14 that is worth exploring, although I'm mindful of  
15 the bank's concern that it's probably a fairly  
16 limited time that it should be explored in. But I  
17 think the approach of having a plan that  
18 contemplates a potential sale is workable. I'm  
19 sure Mr. Austin is aware of the Peridot case in  
20 Atlanta which did that. And particularly if there  
21 are not significant or creditor issues about the  
22 validity of liens and the like. So I think you can  
23 probably do both, if you put the pressure on your  
24 potential acquirers to move promptly.

25 MR. HENES: Thank you, your Honor.

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Your Honor, just my final comment  
would be, I think -- although it may not seem a  
hundred percent, I think we are actually all on  
board, and I do anticipate having something filed  
with the court fairly soon.

THE COURT: Okay.

MR. HENES: Or as soon as we can do  
it in a way that makes sense.

THE COURT: All right.

MR. HENES: Thank you, your Honor.



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C E R T I F I C A T E

STATE OF NEW YORK        }  
                                  }       ss.:  
COUNTY OF WESTCHESTER )

I, Denise Nowak, a Shorthand Reporter and Notary Public within and for the State of New York, do hereby certify:

That I reported the proceedings in the within entitled matter, and that the within transcript is a true record of such proceedings.

I further certify that I am not related, by blood or marriage, to any of the parties in this matter and that I am in no way interested in the outcome of this matter.

IN WITNESS WHEREOF, I have hereunto set my hand this \_\_\_\_\_ day of \_\_\_\_\_, 2003.

\_\_\_\_\_  
DENISE NOWAK