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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

KMC'S REPLY TO THE JOINT OBJECTION OF THE DEBTORS AND THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO THE MOTION OF KMC TELECOM XI LLC FOR AN ORDER DETERMINING THAT THE INFRASTRUCTURE INTERCONNECTION AGREEMENT BETWEEN KMC AND ALLEGIANCE TELECOM COMPANY WORLDWIDE IS INTEGRATED WITH THE PRIMARY RATE INTERFACE SERVICES AGREEMENT AND WAS ASSUMED BY ORDER ENTERED APRIL 6, 2004

KMC Telecom XI LLC ("KMC"), hereby replies to the Joint Objection (the "Objection") of the Debtors and the Official Committee of Unsecured Creditors (the "Committee") (collectively, the "Objectors") to the Motion of KMC Telecom XI LLC for an Order Determining that the Infrastructure Interconnection Agreement Between KMC and

Allegiance Telecom Company Worldwide is Integrated with the Primary Rate Interface Services Agreement and was Assumed by Order Entered April 6, 2004 (the "Motion").[1]

As this Court is aware, this Motion is the last chapter of the disposition by the Debtors of their managed modem business to Level 3, in exchange for $52 million. As part of that transaction, the Debtors assigned the PRI Agreement (by which KMC supplied managed modem services) to Level 3. Initially, KMC objected on the ground that the PRI agreement could not be assumed and assigned unless the Collocation Agreement was assumed as well. KMC ultimately agreed to defer that issue, based on a provision in the April 6 Order (at 3, 6) that to the extent the two agreements should be treated as a single agreement under applicable law, the Debtors would be deemed to have assumed the Collocation Agreement as well. That is the issue presently before the Court.

The Objectors now assert that the PRI Agreement and Collocation Agreement are distinct agreements. As noted below, it simply boggles the mind that Allegiance would give KMC free collocation space were that truly a standalone agreement, and the Objectors have presented no evidence that KMC's potential right to use the collocation space and equipment for third parties – for which it bargained as part of the overall economic arrangements whereby it acceded to the Debtors' PRI pricing request – suddenly separates agreements which were negotiated and signed as part of a single package. Not only is the Objectors' position refuted by the facts and the law set forth in the Motion and the arguments set forth below, but it is expressly contradicted by an internal May 2002 e-mail (Exhibit A hereto) by John Nishimoto, one of the Allegiance negotiators of the two agreements, which explicitly stated that the Collocation

[1] Capitalized terms used but not defined herein shall have the meaning ascribed to such terms in the Motion.

Agreement was "part of the overall network services contract." For the reasons set forth herein, this Court should reach the same conclusion.

In response to the Objection, and in further support of its Motion, KMC respectfully represents as follows:

I. The Objection Ignores the Totality of the Facts and Circumstances of this Case

As this Court may have noted, the Motion and the Objection take a radically different view of the considerations that this Court should take into account when deciding whether the PRI Agreement and the Collocation Agreement were intended to comprise a single transaction or two separate contracts. KMC's Motion addresses the totality of the circumstances of the two agreements; it seeks to tell the whole story of how the Collocation Agreement came to be – how it was meant to function in support of, and to facilitate the pricing under, the proposed PRI Agreement. This accords with the legal standard for such determinations. In re T&H Diner, Inc., 108 B.R. 448, 453-54 (D.N.J. 1989) (finding that the determination of whether a transaction constitutes one or several contracts is primarily based on the intentions of the parties which can "be gathered from all the circumstances surrounding the agreement and from the face of the contract, if [it is] in writing"). By contrast, the Objection eschews any review or analysis of the totality of the circumstances, but instead, in an exercise that smacks more of wordplay than the requisite focus on the parties' intent and economic realities, adopts an isolated focus on a few of the many non-dispositive factors that courts have sometimes mentioned in discussing determining the integrated contract/severability issue.

The three principal factors which the Objectors cite are (a) the alleged absence of an "integration clause;" (b) the absence of cross-defaults; and (c) the possibility that the two agreements would terminate at different times – but their position is incorrect as both a factual and legal matter. Most important, not a single one of the cases they cite suggests that in the

absence of these factors, two agreements necessarily are to be regarded as separate. Rather, at most, some cases finding a single agreement cite these factors among others as supporting that conclusion – which hardly contradicts KMC's view that none of these factors is a litmus test, but rather these factors, as well as others, are to be considered part of a totality of circumstances test.

For example, the Objectors discuss at length the alleged absence of an integration clause, which they interpret to mean a statement in each agreement that the provisions of one contract are incorporated wholesale into the other. Although, as Objectors note (see Objection, at ¶ 12), an explicit statement that "these two pieces of paper are really one contract" might be determinative of the issue, numerous cases find a single agreement to exist without reference to any such integration clause. See, e.g., Commander Oil Corp. v. Advance Food Serv. Equip., 991 F.2d 49, 52-53 (2d Cir. 1993); Pieco, Inc. v. Atlantic Computer Sys. (In re Atlantic Computer Sys., Inc.), 173 B.R. 844, 850-52 (S.D.N.Y. 1994); In re Karfakis, 162 B.R. 719, 725 (Bankr. E.D. Pa. 1993).[2] And in any event, to the extent this "integration clause" is intended as evidence that the two agreements are linked, there can hardly be clearer integration clauses than the statement contained in the Collocation Agreement preamble that its purpose was to enable KMC "to provide certain telecommunications service pursuant to the [PRI Agreement]" (Collocation

[2] The other cases cited by Objectors in ¶12 also do not support their conclusion. Pollock v. Moore (In re Pollock), 139 B.R. 938, 941-42 (B.A.P. 9th Cir. 1992) involved a determination that where a sublease was nonexecutory (because the separate sublease consideration had been fully paid) and was assigned as collateral, the purchase agreement and sublease would be treated as a promissory note secured by a deed of trust rather than a nonseverable contract. See also In re Plitt Amusement Co. of Washington, Inc., 233 B.R. 837, 839, 845 (Bankr. C.D. Cal. 1999) (finding that in a transaction involving a purchase agreement for the business of three theaters, a promissory note to pay the balance of the purchase price over ten years, a security agreement to secure the note by equipment in the theaters, and three theater leases with twenty-year terms, each of three leases was supported by its own consideration, and would continue to exist for decades after the completion of payment for the purchase; opining that the "purpose of an integration clause of this type is to prevent the introduction of parol evidence of other agreements not contained in a particular instrument …[which is] a wholly separate issue from whether the various instruments constitute a single agreement for the purposes of assumption or rejection."); Eisenmann Corp. v. General Motors Corp., C.A. No. 99C-07-260-WTQ, 2000 Del. Super. LEXIS 25, at *68 (Del. Super. Jan. 28, 2000) (opining that if the agreements in question had "contained a tightly-worded integration clause," the result may have been different).

Agreement, at 1), or the provision of § 17 of the Collocation Agreement which refers to the PRI Agreement and provides that the latter controls in the event of any conflict.[3]

The cross-default point is equally irrelevant. Not only is the existence of a cross-default provision no assurance of a single contract, see In re Plitt Amusement Co. of Washington, Inc., 233 B.R. at 847 (holding that cross-default provisions must be disregarded in the bankruptcy law analysis of whether contracts are integrated or severable, because such provisions are impermissible restrictions on assumption and assignment), but in the context of these agreements, the cross-default provision would not have served any real purpose. For example, had Allegiance defaulted under the Collocation Agreement, KMC would have had both a damage claim and, based on the principle that a party cannot claim a breach caused by its own conduct, a complete defense if, in turn, it could not perform under the PRI Agreement. Similarly, if KMC had breached the PRI Agreement, Allegiance would have recovered its damages for that breach, and would neither have had or needed any additional claim on a Collocation Agreement for which it was providing services for free.

Finally, the Objectors' "time of termination" point has no merit either. Notably, the termination provisions of the two agreements – such as the filing of a voluntary or involuntary petition in bankruptcy, non-payment of undisputed amounts, insolvency and like provisions – are remarkably similar (compare PRI Agreement, § 14 with Collocation Agreement, § 5), so there was no reason to make termination of one agreement an event of termination for

[3] There is also some fair amount of confusion in the Objectors' pleadings with respect to what is commonly considered an "integration clause," which is a provision that is typically interpreted to bar parol evidence where an agreement is otherwise clear. Here, the conventional integration clause of each agreement only restricts other agreements "with respect to the subject matter hereof," and there is no inconsistency between finding that each agreement has its own specific "subject matter" – services in one case, and collocation in the other – but that the two subject matters are part of a single contract. (Notably, too, the integration clause in the PRI Agreement, at § 21.2, only restricts reference to prior agreements, and not contemporaneous agreements like the Collocation Agreement).

the other.[4] It is true that the Collocation Agreement could continue after the PRI Agreement ceased – but that was simply a consequence of the fact that KMC bargained for the right potentially to use its equipment for third party service, and it was simply untenable, as a commercial matter, for KMC to enter into commercial contracts with others unless it had the assurance that it could remain in the collocation space for some reasonable duration. See Collocation Agreement, at § 1(b) (term of the later of (i) five years after the Effective Date and (ii) the date of expiration or other termination of the PRI Agreement).

Thus, the contractual nits upon which Objectors rest their case are simply unavailing, either on their own merits or especially when considered in light of the real test for such issues, which requires examination of the contracts and surrounding circumstances as a whole.

This discussion, accordingly, brings us to one central and indisputable point. Try as they might, the Objectors simply cannot ignore the pink elephant in the middle of the room – the economics of the PRI Agreement and the Collocation Agreement. As discussed in the Motion, and as each and every KMC witness testified in their depositions, the pricing of the PRI Agreement was such that, without the accompanying Collocation Agreement, it would not have made any sense whatsoever for KMC to enter into the transaction on the terms to which they agreed. See, e.g., Young Tr. at 19:2 – 21:6;[5] Bittner Tr. at 18:25 – 20:18. Nor would it have made any sense for Allegiance to have entered into the Collocation Agreement, with its free service, or highly discounted third party service, absent the PRI Agreement – and one of the

[4] The Objectors have also suggested in depositions that the fact that the PRI, by its terms, might be assigned without assignment of the Collocation Agreement suggests that the agreements are separate. However, because the PRI Agreement could not be assigned without KMC's consent (see PRI Agreement, at § 21.7), there was no risk that KMC might be left high and dry as to collocation.

[5] Transcripts of the depositions of Kevin Bittner, Anne Falvey, Constance Loosemore and Roscoe Young are attached to the Objection as Exhibits A through D, respectively, and will not be separately attached hereto.

principal Allegiance employees responsible for the KMC transaction, John Dumbleton,[6] Senior Vice President for Wholesale Services so testified:

> Q: Would you have approved the provision of collocation space at no cost to KMC if KMC had not executed the PRI Agreement with Allegiance?
>
> A: I would not have.

Dumbleton Tr., at 30:20-23.

> A: …from my perspective if somebody came to me with a deal that was only collocation there was no other benefit there was no other business associated with that entity, someone came to me and said, I want two racks … for free, the answer would be no. It should be no, and it certainly wouldn't be profitable.

Dumbleton Tr., at 31:16-23 (objections omitted). See also Exhibit E hereto (statement by Mr. Nishimoto of Allegiance forwarding non-standard form of draft collocation agreement as "in support of services we are (hopefully) buying from you");

Given the free pricing under the Collocation Agreement, the fact that it was – as Mr. Nishimoto admitted (see Exhibit A hereto) – "part of the overall network services contract" should be obvious as a matter of common sense. It is also dispositive as a matter of law. See Pieco, Inc. v. Atlantic Computer Sys. (In re Atlantic Computer Sys.), 173 B.R. 844, 850, 855 (S.D.N.Y. 1994) (finding that the lack of economic sense in an agreement, if deemed to be standalone, is a basis for concluding that the agreements should be viewed as an integrated whole).

[6] KMC took the depositions of three Allegiance employees: (i) Mark Tresnowski, General Counsel; (ii) John Dumbleton, Senior Vice President for Wholesale Services, and (iii) John Nishimoto, Senior Director for Wholesale Services . KMC attempted to secure the deposition of Karen O'Connor, Esq., outside counsel to Allegiance in the negotiations surrounding the PRI Agreement and the Collocation Agreement, but Ms. O'Connor refused to submit to deposition. For the Court's convenience, copies of the deposition transcripts have been filed contemporaneously with this Reply as Exhibits B, C and D, and are offered by KMC solely as to the party admissions contained therein, and will be referred to herein and cited as "[Surname of Deponent] Tr., at __."

Still, it is comforting to know that even the Objectors admit that KMC's undertakings under the PRI Agreement were the consideration for the Collocation Agreement:

> Notwithstanding the fact that under certain conditions the collocation space is provided to KMC at no charge … the Debtors, contrary to KMC's assertions in the Motion, did not enter into the Collocation Agreement out of any great sense of charity. Rather, in exchange for the collocation racks provided to KMC, the debtors received (i) services under the PRI Agreement, and (ii) the opportunity to generate revenue from KMC's provision of services to third party customers.

Objection, at ¶ 27 (emphasis supplied). Under these circumstances, there is no basis for treating the PRI Agreement and the Collocation Agreement as separate, because one was consideration for the other, and neither would have been done without the other. See also Exhibit F hereto (statement from KMC counsel Vitenson that form of Collocation Agreement was finalized and "ready for execution pending resolution of the PRI Services Agreement"). Stated differently, when Allegiance assumed the PRI Agreement, it obligated itself as a matter of executory contract law to give KMC the benefit of its bargain as to that PRI Agreement, and that included giving KMC all of the consideration which induced it to enter the PRI Agreement in the first place. The Collocation Agreement was a key part of the benefit of that bargain. Accordingly, the Collocation Agreement should be deemed to have been assumed both as a matter of fairness, as well as under the terms of the April 6 Order.

Although this conclusion should be inescapable, the Objectors seek to muddy the waters. For example, the Objectors intimate that the two agreements were not signed at the same time. See Objection, at ¶ 22. As examination of the times of the fax stamps on the signatures show (see Exhibits G, H and I hereto), this simply is not true. Apart from the time of signature, moreover, the parties were explicit that neither document would be deemed binding unless the other was in force. See Exhibit H hereto (February 11, 2002 e-mail from Allegiance counsel O'Connor referring to the required signature on both documents with signatures then to be

exchanged); Exhibit G hereto (statement by KMC counsel Vitenson together with signature pages that "The effectiveness of the attached signatures is contingent on our receipt of the corresponding counterparts from Allegiance"); Exhibit I hereto (transmittal of Allegiance signature pages by Ms. O'Connor stating that "The effectiveness of Allegiance's signature on these agreements is contingent upon our receipt of the corresponding KMC signature pages."). See also, Exhibit J hereto (reference to statement by KMC counsel to Ms. O'Connor, Allegiance's counsel, that KMC would not sign the PRI Agreement until the Collocation Agreement was complete). Indeed, under the terms of the Collocation Agreement itself (at § 1), it was not effective unless the PRI Agreement came into effect. Thus, the fact that these two agreements were signed on the same day was not happenstance,[7] but further indisputable evidence that they were a *quid pro quo* for one another, and therefore properly regarded as a single agreement.[8]

II. The Objectors' Reliance on the Parol Evidence Rule Clearly is Misplaced

Given the overwhelming extrinsic evidence that the PRI and Collocation Agreement should be viewed as a single contract, it is not surprising that the Objectors seek to

[7] The Objectors suggest (see Objection, at ¶ 15) that simultaneous execution of multiple contracts is not dispositive. Here, the execution was not only simultaneous, but consciously interdependent.

[8] Because each case is controlled by its facts, there is little need to seek to distinguish the cases cited by the Objectors. (Notably, the Objectors did not feel the need to discuss, let alone explain away, the cases cited in the Motion.) However, a brief review of some of the Objectors' cases, not otherwise discussed herein, is instructive. For example, In re Royster Co., 137 B.R. 530, 532 (Bankr. M.D. Fla. 1992) (see Objection, at ¶ 10), involved riders executed long subsequent to the subject car service contract, in some cases on the order of two and three years later, constituted separate and distinct contracts, and thus has nothing to do with these agreements, executed simultaneously. Similarly, In re Integrated Heath Servs., Inc., Case Nos. 00-389 (MFW) through 00-825 (MFW), 2000 Bankr. LEXIS 1310, at *10 (Bankr. D. Del. July 7, 2000) (see Objection, at ¶15) found leases separate from non-competition agreement because they were supported by separate consideration, covered different subject matter, involved different parties and, taken together, the object of the agreements was different, again factors not present here. Nor is In re Plitt Amusement Co. of Washington, Inc., 233 B.R. 837, 839, 845 (Bankr. C.D. Cal. 1999) on point, because (among other things) there, a trustee sought to reject a lease which was at market rates (see id. at 840), so that the lease properly could be deemed to stand on its own, while here, the Collocation Agreement is by definition well below market and therefore would not have been entered into absent the PRI Agreement of which it was a part. Finally, because the issue is severability, and not whether certain terms provisions are incorporated into an agreement, the "expressio unius" principle addressed in paragraph 11 of the Objection is irrelevant.

exclude that evidence and invite the Court to examine only the four corners of the documents themselves. See Objection, at ¶ 10. This approach is misplaced for two reasons. First, even if one limits evidence to the documents alone, their clear language demonstrate that the two agreements are indeed intertwined and should be regarded as one. At a minimum, however, a fair interpretation of the agreements, particularly under the law allowing "surrounding circumstances" to be taken into account, creates a more than ample predicate for considering extrinsic evidence to explain and give context to the contract provisions.

As KMC has stated in the Motion and as reiterated herein, KMC believes that even if the Court were to rule based solely on the words and economic terms contained in the PRI Agreement and the Collocation Agreement, it should find that the documents comprise a single, integrated transaction, mandating the conclusion that the Collocation Agreement was assumed by operation of the April 6 Order. Among other things:

- The preamble to the Collocation Agreement is explicit that it was entered into precisely to enable KMC to perform under the PRI Agreement;
- The Collocation Agreement expressly states (at § 17) that in the event of a conflict between it and the PRI Agreement, the PRI Agreement controls, demonstrating that the Collocation Agreement was intended to support, and flow with – rather than undermine – the PRI Agreement;
- The effective date of the Collocation Agreement is defined (at § 1) as the date on which the PRI Agreement becomes effective;
- Specific provisions of the PRI which are pertinent to the Collocation Agreement are incorporated by reference (at § 18);[9] and
- Perhaps most important, Allegiance is offering the vast bulk of its collocation service for free, which makes absolutely no sense as part of a standalone, separate collocation agreement.

[9] As discussed above, the Objectors' "integration clause" argument makes the assumption that unless every single provision of another agreement is incorporated by reference, the two agreements must be deemed independent. Although one admires the Objectors' effort to make a silk purse from a sow's ear, there is no basis for such a conclusion.

To the extent that these provisions are not dispositive of the issue in KMC's favor, it is at a minimum true that the fact that the Objectors (albeit erroneously, in KMC's view) and KMC interpret the same two documents to lead to precisely the opposite conclusion illustrates the lack of clarity of the agreements, and provides the predicate for the Court to allow and consider evidence outside the four corners of the agreements.

The Objectors' own cited cases buttress this conclusion. Quoting True North Communications, Inc. v. Publicis S.A., 711 A.2d 34, 38 (Del. Ch. 1998), the Objectors assert that "[i]n interpreting contracts under Delaware law, a court must first determine whether the 'contractual language in question is ambiguous.'" Objection, at ¶ 10. However, the True North Court further opined that if "the contract language in question is reasonably subject to more than one interpretation, the Court will consider parol evidence in order to ascertain the parties' intentions." 711 A.2d at 39. Notably, despite finding "that the words in controversy cannot be read reasonably in the manner suggested" by one of the litigants, the True North Court nonetheless "admitted all of the extrinsic evidence offered by the parties in order to ascertain the parties' intentions" in recognition of the fact that the parties therein had "advanced completely inconsistent interpretations of the contract language in question." Id. (considering affidavits and documents regarding the negotiating history of the disputed language under a pooling agreement, as well as live testimony by witnesses directly involved in the contract negotiations).

In addition, determining whether two documents comprise a single agreement necessary contemplates introduction of evidence to create context and meaning as to the contractual provisions. This is again supported by cases upon which Objectors rely. For example, the Objection (at ¶ 10) quotes City Investing Company Liquidating Trust v. Continental Casualty Co., 64 A.2d 1191, 1198 (Del. 1993), as standing for the proposition that "[i]f a writing is plain and clear on its face, i.e., its language conveys an unmistakable meaning,

the writing itself is the sole source for gaining an understanding of the intent." Although the Objectors quote the case accurately, they ignore the very next sentence penned by the Delaware Supreme Court: "[h]owever, if the words of the agreement can only be known through an appreciation of the context and circumstances in which they were used[,] a court is not free to disregard the extrinsic evidence of what the parties intended." City Investing Co., 624 A.2d at 1198 (internal quotation omitted). That is exactly the point.

Finally, the Objectors (see Objection, at ¶10) cite Atlantic Mutual Ins. Co. v. Balfour MacLaine Int'l Ltd. (In re Balfour MacLaine Int'l Ltd.), 85 F.3d 68 (2d Cir. 1996) for the proposition that the intent of the parties is ascertained by reference to the text of the subject matter. However, the Balfour Court went on to say that "the severability of a contract is a question of intent to be determined from the language employed by the parties, viewed in light of the circumstances surrounding them at the time they contracted." 85 F.3d at 81 (construing New York law). For all these reasons, Objectors' reliance on the parol evidence rule as supporting a judgment in their favor is misplaced.[10]

III. The Third Party Red Herrings

Under the Collocation Agreement, KMC was enabled to render service to third parties by using the equipment which it was using for Allegiance, or other equipment that it would place in the collocation space. The Objectors argue (¶¶ 3, 31-32) that KMC's ability to provide such service gave it advantages which preclude a finding that there is a single contract here, and further argue (¶¶ 6, 33-36) that KMC's alleged failure to notify Allegiance of such

[10] Interestingly, the Objection itself is rife with arguments based on extrinsic evidence, as well as citations to deposition testimony. See, e.g., Objection, at ¶¶ 31-32 (discussing settlement negotiations in respect of a potential buyout by Level 3 of the PRI Agreement); ¶¶ 6, 33-36 (discussing KMC's arrangements subsequent to entry into the PRI Agreement and the Collocation Agreement to service third-party customers from Allegiance Space, as permitted under the Collocation Agreement). Although KMC believes that for reasons more fully discussed in Sections III and IV, infra, these arguments are unavailing and not relevant to the issue of the parties' intent at the time of contract formation, the Objectors' own use of extrinsic evidence it is at least probative of the fact that the Court

third party service or pay for it constitutes "unclean hands" which should cause KMC to be denied any relief. There is no factual or legal basis for either of these contentions.

First, the fact that KMC was able to use the collocation space for third parties was part and parcel of the consideration for the business arrangement which was reflected in the PRI/Collocation Agreement deal. KMC will show at trial that during the initial negotiations, it resisted locating its equipment in Allegiance's collocation space, and preferred to lease its own collocation space and pass the costs to Allegiance as part of an overall PRI charge. Ultimately, KMC agreed to use Allegiance's collocation space, and as negotiations continued, the pricing for that space was reduced to zero in order to induce KMC to agree to the PRI pricing which Allegiance had sought. But KMC would not agree to invest some $15 million for equipment to service the Allegiance business unless it could also use that equipment to seek business from third party customers.[11] Thus, part and parcel of the consideration for the PRI Agreement was the right of KMC, under the terms of the Collocation Agreement, and at favorable prices, to service third parties from the collocation space under the terms set forth in the Collocation Agreement. None of this, therefore, is a basis for treating the two agreements as separate. To the contrary, it merely illustrates the intimate connection between the PRI Agreement and the Collocation Agreement that supports treating them as a single agreement.

The Objectors' "unclean hands" point is even more baseless. Incredibly, Objectors state that "the Debtors have not received a single payment from KMC" and that "KMC never notified the Debtors that it was providing service to third parties from the collocation

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(continued…)
cannot base a decision in Objectors' favor solely on the four corners of the contract.

[11] The Objectors (see Objection, at ¶ 27) confusingly describe this as "access to Tier 1 markets." In fact, although the collocation sites are physically located in some of the large cities which are known as "Tier 1 markets," that fact alone does not enable KMC to serve Tier 1 markets. Even if it did, moreover, that was part of the parties' overall bargain.

space." (Objection, ¶ 34 & n. 10). To the extent that Objectors' position had any credibility, it is shattered by the falsity of these statements. As a technical matter, as the Debtors well know, it was not possible for KMC to have connected third parties to its equipment unless that connection was performed by Allegiance. Attached hereto as Exhibit K are an illustrative example of a connection service order issued by KMC to Allegiance and a confirmatory e-mail from Allegiance acknowledging the order. The fact that it is an Allegiance technician who makes the physical connection to a third party was acknowledged by Allegiance's Senior Vice President for Wholesale Services during his deposition:

> Q: Physically, would something have to be done to the equipment to allow KMC to provide the service to a third party?
>
> A: Two things would need to happen. The first thing is the equipment would need to be configured to offer, in this case, I believe it's 2A (ph) PRI services. Second thing is the third party customer would need to somehow connect to that equipment, you know, logically through an IP connection that exists today or physically through a cross-connect.
>
> …
>
> Q: This cross connect, is that something that someone at the Allegiance switch site would physically have to do?
>
> A: Yes, physical cross-connect it.
>
> Q: Would that be done by someone at Allegiance?
>
> A: That would be done by an Allegiance technician.
>
> Q: And how would the technician know how to do that?
>
> A: An order would be placed for a physical cross-connect. An order would be placed in the system.

Dumbleton Tr., at 33:14-25, 34:13-25. Apart from this theoretical knowledge, Mr. Dumbleton's testimony further confirmed that he knew since at least as early as mid-to-late 2003 – shortly after KMC brought its first third-party customer on line – that KMC was providing service to third-party customers out of the collocation space:

Q Have you had any discussions with anyone with respect to whether or not KMC provides service to third parties from that collocation space?

A: I've asked that question of my people.

Q: And what was the substance of those conversations?

A: The substance of the conversation was that we believed they are.

Q: And when were those discussions?

A: Mid to late '03.

Dumbleton Tr., at 32:15-24.

Had Allegiance checked its records before making its severe allegations in court pleadings, it would have also learned that in fact, KMC paid all amounts which were billed by Allegiance for third party services. See Exhibit L hereto. Although the Debtors may dispute the interpretation advanced by KMC's witnesses as to what amounts are payable (see Objection, ¶ 34), it is noteworthy that the amounts billed by Allegiance under the Collocation Agreement – consisting only of connection charges and not monthly rentals – comports with KMC's interpretation. Thus, it is simply false that Allegiance would have the right to terminate the Collocation Agreement under Section 5(a)(i) because of a KMC payment breach, as Objectors allege (see Objection, at ¶ 35). Termination can occur only if after 30 days notice, KMC fails to pay "any undisputed amount owed to Allegiance as required by this Agreement," which at a minimum requires (per the Collocation Agreement, at § 4) that Allegiance render a bill for the monthly rentals it appears to allege are due – which Allegiance has yet to do.

This Court need not now resolve how much, if anything, KMC may owe Allegiance under the Collocation Agreement. Once it is deemed that the Collocation Agreement has been assumed under the April 6 Order, the parties can resolve that issue using whatever forums (including, if appropriate, the bankruptcy court) and people necessary for resolving such

factual disputes, subject to the dispute resolution procedures set forth in § 22 of the PRI Agreement and incorporated into the Collocation Agreement at § 18. None of that, however, has anything to do with the issues now before the Court.[12]

IV. The December 2003 Settlement Negotiations

In apparent violation of Rule 408 of the Federal Rules of Evidence, the Objectors ask this Court to consider KMC's December 2003 settlement negotiations with Allegiance and Level 3 that involved the potential termination of the PRI Agreement. According to the Objectors, KMC wanted to assure that it could stay in the collocation space even if it was no longer providing service to Level 3.

So what?

As noted above, KMC's ability to use the equipment to serve third parties was an integral part of the deal by which it bought $15 million of equipment and agreed to install it in Allegiance's collocation space. It was natural, accordingly, that KMC would seek to keep that collocation space (and indeed, even to extend the period of use) as part of overall settlement negotiations. Contrary to the Objectors' position (see Objection, at ¶ 32), the relevant issue is not whether KMC received benefits from the Collocation Agreement "other than pricing considerations regarding the PRI Agreement," but whether the two agreements were part of the same deal or separate deals. On that subject, KMC suggests that there can be only one conclusion – that the Collocation Agreement is "part of the overall network services contract." See Exhibit A.

[12] There is even an argument that Objectors' raising the issue at this time is itself a breach of the dispute resolution procedures – but again, this Court need not occupy itself with such matters now.

V. Conclusion

For the reasons set forth herein and in the Motion, and based on the evidence which KMC will introduce at trial, KMC urges that this Court overrule the Objection and determine, in accordance with the Level 3 Order, that the Collocation Agreement has been assumed by the Debtors.

Dated: New York, New York
May 19, 2004

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