

2 UNITED STATES BANKRUPTCY COURT
3 FOR THE SOUTHERN DISTRICT OF NEW YORK

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4 In The Matter Of

5
6 Case No.:

03-13057

7
8 ALLEGIANCE TELECOM, INC.,

9 Debtor

10 -----x

11
12 December 18, 2003

10:32 a.m.

13 United States Custom House

One Bowling Green

New York, New York 10004

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16 Hearing re: Continue on Motion for Approval
17 Using of Cash Collateral; Motion to Approve Certain
18 Settlement Agreement with AT&T Corp. and Authorize the
19 Assumption of Executory Contracts, as Amended, with
20 AT&T Corp.

21 B E F O R E:

22 HON. ROBERT D. DRAIN,

23 Bankruptcy Judge.
24
25

1 Allegiance Telecom, Inc.

2 A p p e a r a n c e s:

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9 LUDMILA CHUPLYGINA, ESQ.

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14 Committee of Unsecured Creditors

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18 BY: PHILIP DUBLIN, ESQ.

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BY: MARK R. SOMERSTEIN, ESQ.

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17 BY: JOHN JOSEPH WILLIAM INKELES, ESQ.

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Allegiance Telecom, Inc.

A p p e a r a n c e s :

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1 Allegiance Telecom, Inc.

2 THE COURT: Allegiance.

3 MR. CANTOR: Matthew Cantor,
4 Kirkland & Ellis, on behalf of the debtors.

5 Your Honor, first is the motion
6 approving a settlement between the company and
7 AT&T. We requested that it be held in camera.

8 THE COURT: I haven't seen any
9 opposition to the settlement. In light of the
10 fact that I read the papers, the unredacted
11 papers, and I'm certainly aware of the dispute,
12 which has been considerable, do you think that
13 we need to go off the record? Do you really
14 need to get into anything that's particularly
15 sensitive at this point?

16 MR. CANTOR: Your Honor, my
17 colleague, Ludmila Chuplygina, is going to
18 handle the hearing and she can answer the
19 questions.

20 MS. CHUPLYGINA: Your Honor, I
21 really don't need to get into the details of
22 the settlement agreement. The major terms are
23 in the papers, so I can think I can go over the
24 issue briefly without disclosing any
25 confidential information, so we can do it

1 Allegiance Telecom, Inc.
2 without having it in camera.

3 THE COURT: Given the number of
4 people involved, that makes sense.

5 MS. CHUPLYGINA: So, as just my
6 colleague said, this is a motion to approve a
7 settlement agreement between the debtors and
8 AT&T Corporation that we entered on December
9 10th subject to Your Honor's approval and also
10 to approve the assumption of the two agreements
11 with AT&T as amended by the AT&T amendment.

12 We filed the motion on
13 December 12. We served it by overnight mail on
14 the master service list in accordance with the
15 order of notice. We also provided to Your
16 Honor and counsel to the Creditors' Committee,
17 counsel to prepetition lenders and U.S. Trustee
18 with the agreements which were filed under
19 seal.

20 We didn't receive any objections
21 to the motion. We believe that the settlement
22 falls well within the range of reasonableness.
23 We also believe that the assumption of this
24 agreement is beneficial to the estates.

25 The result of the settlement

1 Allegiance Telecom, Inc.
2 would be that we're resolving all disputes with
3 AT&T without any judicial intervention. The
4 debtors will pay lower rates under the
5 agreement, AT&T will pay higher rates, and
6 there are certain other beneficial provisions
7 in the agreements that we entered into.

8 There has been only one change
9 since we filed the motions and submitted the
10 documents to you, and that was that under the
11 settlement agreement, we have to withdraw the
12 two rejection motions within five business days
13 from the date of entry of the order approving
14 the settlement agreement. The Creditors'
15 Committee asked us to withdraw the motions two
16 business days after such order becomes final
17 and AT&T agreed with that.

18 So that with our resolution of
19 this issue and having said that, I would like
20 to ask Your Honor to approve this motion.

21 THE COURT: Okay. Are you --

22 MR. INKELES: John Inkeles from
23 Lowenstein Sandler for AT&T. We have no
24 objections, Your Honor.

25 THE COURT: Okay. So you're

1 Allegiance Telecom, Inc.
2 fine with that change.

3 MR. SOMERSTEIN: Mark
4 Somerstein, Kelley Drye, for the Creditors'
5 Committee. With that one change the Committee
6 has requested, the Committee has no objection.

7 THE COURT: Okay. Well, as I
8 said, this involves a complicated litigation
9 that's been pending before the Court for a
10 while. I'm sure it's being reviewed by the
11 Committee as well as the debtor, and in light
12 of there being no objections, I'll approve it.

13 MS. CHUPLYGINA: Thank you, Your
14 Honor.

15 The next item that we have on
16 the agenda is approval of the second amended
17 final order authorizing our use of cash
18 collateral by consent. We filed it on
19 November 20th by notice of presentment. There
20 were no objections filed and we told Your Honor
21 on Tuesday that the Creditors' Committee was
22 going to file an objection, which we did
23 resolve, and I would like to tell Your Honor
24 briefly what was the resolution.

25 The issue was related to

1 Allegiance Telecom, Inc.
2 retention of the second financial adviser for
3 the lender group. All parties agreed that this
4 financial adviser would be retained nunc pro
5 tunc to October 6th, 2003. There would be no
6 success fee payable to this adviser. The
7 monthly fee will be \$150,000 plus expenses.

8 We also agreed that as far as
9 the termination date for the financial adviser
10 for the lenders are concerned, the sale
11 transaction, the potential sale transaction,
12 will provide for distributions to the lender
13 group at 100 percent in cash in full amount,
14 the Lazard retention will be through the date
15 of the order approving the sale, and FTI, who
16 is the second financial adviser, their
17 retention thereby through the date of the
18 closing of the sale. If the distribution to
19 the lenders will be a combination of cash and
20 some other consideration, then we look through
21 the day of confirmation for Lazard and through
22 the effective date of the plan for FTI.

23 In short, this is the
24 resolution. I'm sure that counsel for the
25 lenders and counsel for the Creditors'

1 Allegiance Telecom, Inc.
2 Committee will correct me if I misrepresented
3 anything.

4 And the other important change
5 in the second amended order is that the
6 expiration date, which under the current order
7 is December 31st, will be extended to March 1st
8 of 2003.

9 MS. PLASKON: Leslie Plaskon on
10 behalf of the lenders. That is an accurate
11 description.

12 MR. DUBLIN: Phil Dublin on
13 behalf of the Committee. One slight
14 modification is that if the transaction doesn't
15 provide for all cash, any other type of
16 consideration, it would be the second option,
17 which is Lazard until confirmation and FTI
18 until the effective date.

19 MS. PLASKON: That's correct. I
20 actually thought that counsel for the company
21 explained that. We actually have documented
22 this arrangement in a separate letter
23 agreement, so that we will actually have a
24 piece of paper that documents the terms of the
25 settlement.

1 Allegiance Telecom, Inc.

2 THE COURT: Okay. All right. I
3 have to confess I'm a little doubtful as to why
4 you need two advisers if you're getting notes
5 instead of cash through the confirmation date,
6 but this is really a cash collateral agreement
7 by the Committee, so --

8 MR. DUBLIN: One other comment:
9 Lazard hasn't provided time records in this
10 engagement.

11 MR. CANTOR: One other issue.
12 In the budget there is a line item for the
13 payment of year-end bonuses to the company's
14 employees, bonuses that I'm given to understand
15 have been traditionally paid this way in past
16 practice. The banks support the payment of the
17 bonuses in the budget. The Committee had sent
18 us a letter telling us last night that they
19 need more information concerning those bonuses.

20 Notwithstanding it being in the
21 budget, we won't pay these bonuses until we've
22 had an opportunity to review the issue with the
23 Committee, answer their questions and get them
24 comfortable. And if we're unable to get them
25 comfortable, we may be back before Your Honor

1 Allegiance Telecom, Inc.

2 on this cash collateral order.

3 These are year-end bonuses to
4 incent salespeople to sell, to incent senior
5 management to keep the company viable. You're
6 going to hear that these bonuses and the
7 payment of the bonuses is important as it
8 relates to the next matter, which I'll be able
9 to explain more later.

10 So this is something very
11 important to the company and our agreement not
12 to pay it now shouldn't suggest that we don't
13 think it's critical, but we want to continue
14 working in a cooperative manner.

15 MR. DUBLIN: Mr. Cantor is
16 correct. We have requested additional
17 information. Based on our understanding of the
18 procedures in the initial cash collateral
19 order, the Committee will be provided with an
20 agreed-upon budget between the lenders and the
21 debtors. The agent had objected at this time
22 to certain issues in the budget. We have not
23 since then received a subsequent budget, so we
24 think our period to oppose the budget exists.

25 We also think -- this \$10

1 Allegiance Telecom, Inc.
2 million dollar payment, we believe it's outside
3 the ordinary course and the type of issue that
4 you do have to take under advisement. As
5 Mr. Cantor said, this has not been paid in the
6 last two years, which is set forth in the
7 company's first day motions, the company's
8 seeking to get payments to the employees.

9 THE COURT: All right. With
10 those clarifications on the record and my
11 understanding that there have been no other
12 changes to the revised cash collateral --

13 MS. CHUPLYGINA: No. No
14 specified changes.

15 THE COURT: All right. I will
16 approve it on that basis.

17 MR. CANTOR: Your Honor, we had
18 an additional matter come up which wasn't on
19 the agenda.

20 THE COURT: Right.

21 MR. CANTOR: We have been able
22 to reach an agreement to sell substantially all
23 of the company's assets and businesses save a
24 few smaller items that I'll describe in more
25 detail. We bench filed a motion. The issue

1 Allegiance Telecom, Inc.
2 is: We've come down to asking the Court to
3 enter an order fixing a time, date and place.
4 This is what we talked about in the chambers
5 conference. My life has not gone sideways and
6 we're back here today. So we're presenting up
7 today, asking you to fix January 9th at 10:00
8 in the morning as a date for a hearing to
9 approve our bidding procedures.

10 THE COURT: Right.

11 MR. CANTOR: The buyer is
12 reluctant to exchange signature pages with us
13 unless we are able to get Your Honor to
14 authorize us to abide by and be directed to
15 abide by the no-shop provisions in the asset
16 purchase agreement. I believe the sale motion
17 and the asset and purchase agreement were
18 delivered to your chambers.

19 THE COURT: I didn't actually
20 see the asset purchase agreement. So what I'd
21 like to do is -- if you can hand up to me the
22 relevant provision, which is 6.17A --

23 MR. CANTOR: Yeah, I have that,
24 Your Honor.

25 THE COURT: Okay.

1 Allegiance Telecom, Inc.

2 MR. CANTOR: Your Honor, as
3 you've seen, effectively the language basically
4 prevents and prohibits the company from going
5 out shopping.

6 THE COURT: During this gap
7 between now and the 9th or the date of the
8 bidding procedures order?

9 MR. CANTOR: Yes. And this has
10 been very important. So if Your Honor is of a
11 mind to approve that, I would like to go ahead
12 and give you a brief description of what the
13 deal is.

14 I will tell you that the banks
15 support this transaction and have no objection
16 to the entry of that order in front of you.
17 The Creditors' Committee has no objection to
18 the entry of that order. So I would request
19 that you first set the hearing date with one
20 exception. I think we're requesting
21 January 5th as the objection deadline. Since
22 the 9th would be the hearing, we've given some
23 opportunity to respond.

24 THE COURT: That would be the
25 8th at 12:00. It's on short notice and we have

1 Allegiance Telecom, Inc.

2 the holidays, so -- these aren't new issues for
3 people, so --

4 MR. CANTOR: The 7th?

5 THE COURT: Let's stick with the
6 8th at 12:00.

7 MR. CANTOR: Okay, Your Honor.

8 THE COURT: And just one
9 clarification. Since it uses the language
10 "directly or indirectly," I just want
11 clarification that this does not prohibit you,
12 obviously, from giving notice of the bidding
13 procedures motion.

14 MR. CANTOR: We acknowledge that
15 it prohibits us from giving notice. Paul Basta
16 represents the purchaser.

17 MR. BASTA: Nothing prohibits
18 giving notice.

19 THE COURT: That won't change
20 the objection deadline. I'm comfortable with
21 the relief that's being sought as an inducement
22 to get this prospective buyer to sign the
23 agreement and to move forward with the
24 bankruptcy sale process, so I'll enter the
25 order with that one change, that the objection

1 Allegiance Telecom, Inc.

2 deadline is 12:00 p.m. on the 8th.

3 MR. CANTOR: Your Honor, just by
4 way of background, the purchaser is Quest
5 Communications International. We're very happy
6 with the transaction. We'll effectively be
7 selling substantially all the assets and
8 businesses of the company except for a few
9 smaller businesses like our shared technology
10 business and our hosting business. We are
11 going to retain some contracts that we think
12 we'll be able to achieve greater value by
13 either retaining them or selling them in a
14 different transaction.

15 There was a cloud, a dispute,
16 over one of the big contracts which you will
17 hear more about later on. Again, it's -- as
18 you know, this has been going on for months.
19 Greenhill, Lazar, Houlihan and the banks have
20 all been working hard together. All the banks
21 and lawyers have done a great job, I think, to
22 this point, and the purchase price would be for
23 \$300 million in cash plus \$90 million in
24 convertible notes plus the assumption of a
25 substantial amount of postpetition liabilities.

1 Allegiance Telecom, Inc.

2 We think it's a great outcome for the company
3 and the creditors in particular.

4 THE COURT: Okay. Well then,
5 we'll see you back here on the 9th, and
6 hopefully -- except for Mr. Basta, hope you'll
7 have an active auction there.

8 MR. CANTOR: Yes. Have a good
9 holiday.

10 THE COURT: Thank you.

11 (Time noted: 10:49 a.m.)

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Allegiance Telecom, Inc.

C E R T I F I C A T E

STATE OF NEW YORK)

)°

COUNTY OF NEW YORK)

I, KATHLEEN A. KEEFE, a Registered Professional Reporter and Notary Public in and for the State of New York do hereby certify:

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 29th day of December, 2003.

KATHLEEN A. KEEFE, R.P.R.

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