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**HEARING DATE: 6/2/04**  
**AT: 10:00 A.M.**

UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK

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

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**RESPONSE OF THE DEBTORS TO MOTION BY BELLSOUTH  
TELECOMMUNICATIONS, INC. PURSUANT RULE 3018(a)  
FOR ORDER TEMPORARILY ALLOWING CLAIMS FOR  
PURPOSES OF VOTING TO ACCEPT OR REJECT DEBTORS'  
SECOND AMENDED JOINT PLAN OF REORGANIZATION**

Allegiance Telecom, Inc. and its direct and indirect subsidiaries, as debtors and debtors in possession (collectively, "Allegiance" or the "Debtors"), for their response to the Motion by BellSouth Telecommunications, Inc. ("BellSouth") pursuant to Federal Rule of Bankruptcy Procedure 3018 for an order temporarily allowing claims for purposes of voting on the Debtors' plan of reorganization, dated May 21, 2004, and as supplemented on May 25, 2004 (the "Motion"), respectfully state that:

**Preliminary Statement**

1. BellSouth seeks to have the claims it filed by it against the Debtors (the "BellSouth Claims"), which are the subject of objections by the Debtors,

temporarily allowed for purposes of voting on the Debtors' proposed plan of reorganization. The BellSouth Claims are addressed in the Debtors' fourth objection to certain proofs of claim filed by BellSouth, dated May 26, 2004 (the "Fourth Objection"). The Fourth Objection seeks to disallow the BellSouth Claims on substantive grounds.

2. BellSouth argues in the Motion that it should be allowed to vote the BellSouth Claims based on the contention that they hold substantial claims against the Debtors and no colorable objection to them has been made by the Debtors. It is noted that BellSouth filed the Motion before the Fourth Objection was filed.

3. For the reasons set forth below, the Debtors request that this Court not allow the BellSouth Claims for plan voting purposes, as they are, in fact, susceptible to expungement based on meritorious substantive grounds.

#### **Background**

4. Allegiance is a facilities-based national local exchange carrier that provides integrated telecommunications products and services to small and medium-sized business customers, large businesses (i.e., national customers with multiple locations), governmental entities and other institutional users. Allegiance offers its customers a variety of services, including:

- local and long distance voice services, including basic telephone services and advanced calling features;
- broadband and other Internet and data services, including high-speed Internet access, wide area network interconnection, domain name registration, web hosting, email and collocation services;
- integrated local long distance / Internet access offerings, which provide customers with integrated voice and Internet access over a single broadband line;
- equipment collocation, managed modem ports and Internet protocol traffic aggregation; and

- customer premise equipment sales and maintenance services.

### **Claims Bar Date**

5. In the Debtors' chapter 11 cases which were commenced on May 14, 2003, the Court entered an Order dated September 23, 2003, pursuant to Bankruptcy Rule 3003(c)(3), (i) establishing a final date for filing proofs of claim in these chapter 11 cases, and (ii) approving the form of the bar date notice and the notice and publication procedures (the "Bar Date Order"). The Bar Date Order, among other things, established November 26, 2003 (the "Bar Date") as the last date for all persons and entities (including governmental units) holding or wishing to assert pre-petition and certain other "Claims" (as such term is defined in 11 U.S.C. § 101(5)) against the Debtors to file a proof of claim with respect to each such Claim.

6. Within fifteen (15) days of the entry of the Bar Date Order, the Debtors' notice and claims agent, Bankruptcy Management Corporation ("BMC" or the "Voting Agent"), provided notice of the Bar Date by mailing (i) the notice of the Bar Date approved by the Court (the "Bar Date Notice") and (ii) a proof of claim form upon the persons or entities listed in the Debtors' Schedule of Assets and Liabilities (the "Schedules"), which were previously filed with the Court, and upon those additional parties listed in the Bar Date Order.

7. In addition, the Debtors published the Bar Date Notice in the USA Today (National Edition) on one occasion at least twenty-five (25) days before the Bar Date.

### **Plan of Reorganization**

8. By an Order dated April 22, 2004, this Court, *inter alia*, (i) approved the Debtors' Second Amended Disclosure Statement Pursuant to Section

1125 of the Bankruptcy Code relating to their Amended Joint Plan of Reorganization, as thereafter amended (the "Plan"), (ii) established various dates and procedures regarding voting to accept or reject the Plan, (iii) prescribed procedures for filing objections to confirmation of the Plan, and (iv) scheduled a hearing to consider confirmation of the Plan (the "Disclosure Statement Order").

9. Pursuant to the Disclosure Statement Order, ballots for voting on the Plan must be received by the designated Voting Agent of the Debtors by June 1, 2004. Further, the disclosure Statement Order provides that holders of claims against the Debtors that are subject to objection based on liability and/or amount are entitled to vote their claims for or against Plan confirmation in the amount of one (\$1.00) dollar. The hearing to consider confirmation of the Plan is scheduled for June 7, 2004 at 10:00 a.m.

#### **Debtors' Objections to the BellSouth Claims**

10. The Fourth Objection seeks to disallow the BellSouth Claims on the following grounds: (i) the claim amounts are disputed, miscalculated and overstated; (ii) the claims are subject to set off rights of the Debtors for amounts due and owing by BellSouth to the Debtors and for deposits paid by allegiance to BellSouth; and (iii) the claims are disallowed under section 502(d) of title 11 of the United States Code (the "Bankruptcy Code") as a result of the Debtors' preference claims against BellSouth.

#### **Debtors' Opposition to the Motion**

11. The Debtors object to the temporary allowance of the BellSouth Claims for the reasons set forth below and requests that this Court deny the Motion. The Debtors have substantive objections to the BellSouth Claims. These grounds

include that the claims are disputed and overstated, are subject to set-off rights of the Debtors and are disallowed pursuant to section 502(d) of the Bankruptcy Code. These are well-supported and valid objections and constitute a sufficient basis for the Court to deny temporary allowance of all of the BellSouth Claims for Plan voting purposes.

### **Overstated Claims**

12. The Debtors purchase various telecommunications facilities and services on a wholesale, retail, or other basis, from BellSouth. The Debtors use most of these services to provide its own integrated telecommunications products and services to Allegiance customers. The Debtors also provide certain telecommunications facilities and services to BellSouth that BellSouth uses to provide services to its customers. The relationship between the Debtors and BellSouth and the charges for the subject services is governed, among other things, by state and federal tariffs (the "Tariffs") and Interconnection Agreements ("ICA").

13. Since telecommunication traffic flows in both directions, on a monthly basis both parties have amounts due to and from each other. In general, Allegiance reviews and analyzes charges from BellSouth upon receipt of BellSouth's invoices and, except as explained below, all charges that Allegiance determines are appropriate are paid, and the balance of the disputed charges are set aside for resolution at a later date. As these disputed charges accumulate, they can result in a significant amount. Periodically, representatives from both Allegiance and BellSouth settle the disputed amounts but that has not occurred for these claims. Here, significant portions of the claims that BellSouth assert as unpaid pre-petition amounts continue to be disputed.

14. The Debtors have reviewed the BellSouth Claims and have determined that such claims are overstated. BellSouth has asserted amounts that are not due under the ICA or Tariffs, or has miscalculated or otherwise improperly asserted the amounts due by the Debtors to BellSouth. The Debtors' books and records reflect that the total pre-petition amount actually invoiced by BellSouth under the ICA and Tariffs is \$1,915,891. After taking into consideration the pre-petition disputed and overstated amounts of \$845,082 invoiced by BellSouth per the Debtors' books and records, the aggregate of the BellSouth Claims should be reduced to \$1,070,809.

15. In addition to the foregoing reductions, the BellSouth Claims should be further reduced based on certain rights of set off that the Debtors have against BellSouth as discussed below.

#### **Setoff Rights**

16. Section 553 of the Bankruptcy Code preserves the non-bankruptcy rights of parties (creditors and debtors) to effect set off of mutual obligations. Allegiance's books and records show that the pre-petition claims in favor of the Debtors against BellSouth arising under the ICA or Tariffs total \$918,231. In addition, BellSouth is holding a pre-petition deposit paid by Allegiance in the amount of \$1,060,810. Consequently, Allegiance may set off such amounts due and the deposit against the BellSouth Claims. After reduction of the BellSouth Claims on account of the disputed and overstated amounts, the aggregate of the BellSouth Claims must be further set off by the amounts due from BellSouth and the deposit. The result is that the BellSouth Claims should be reduced to zero.

#### **Discussion**

17. In deciding whether an objected to claim should be temporarily allowed for plan voting purposes courts examine the merits of the claim objection and how the debtors listed potential liabilities owing to the creditor in its schedules. See In re Stone Hedge Properties, 191 B.R. 59 (Bankr. M.D. Pa. 1995).

18. In the present case, Allegiance scheduled many of the BellSouth related claims as contingent, unliquidated and disputed. Thus, from early on in these chapter 11 cases, BellSouth was on notice that the Debtors had serious issues with the validity of potential BellSouth claims and the process by which BellSouth might arrive at claim amounts. Further, BellSouth, as well as other major ICA providers that Allegiance has relationships with, such as SBC Telecommunications and Verizon Communications, have been in protracted discussions during the cases regarding the obligations running between them under the ICA and Tariffs. Therefore, there can be no question that BellSouth has been long aware of the position of the Debtors concerning the BellSouth Claims and the potential for objection to the claims.

19. The bases for the objections to the BellSouth Claims are well founded. The Debtors have legitimate grounds to contest the overstated and improper charges asserted in the BellSouth Claims. Likewise, the BellSouth Claims do not take into account the significant pre-petition charges owed by BellSouth to Allegiance under the ICA and Tariffs and the deposit held by BellSouth. Taken together, the Debtors' right of set off and the elimination of the BellSouth overcharges reduce the aggregate of the BellSouth Claims to zero.

20. The underlying purposes of the Bankruptcy Code are to be considered by the courts in evaluating a motion for temporary allowance of a claim. See Stone Hedge, at 65. By the relief sought in the Motion, BellSouth seeks the ability

to vote the full amount of claims for or against confirmation of the Plan that in face amount far exceed any amount of the actual obligations owed by Allegiance, if there are any such net obligations due by the Debtors. Though a creditor's right to vote on a plan of reorganization is not to be withheld lightly, the competing purposes of the Bankruptcy Code to ensure fairness and integrity in the voting process cannot be ignored. BellSouth should not be permitted to wield disproportionate and unjustified influence in the voting on Plan confirmation by temporary allowance of its vastly inflated unsecured claims. To do so would be highly prejudicial to the rights of all of the holders of allowed unsecured claims against the Debtors. The voting of all of the BellSouth Claims in their full amounts would unfairly dilute the impact of the votes of the rest of the unsecured creditors. Accordingly, this Court should deny the Motion.

**WHEREFORE**, the Debtors respectfully request that the Court (a) deny the Motion, which seeks temporary allowance of all of the BellSouth Claims for Plan voting purposes, and (b) grant such further relief as it deems just and proper under the circumstances.

Dated: New York, New York  
May 28, 2004

Respectfully submitted,

ALLEGIANCE TELECOM, INC., *et al.*,  
Debtors and Debtors in Possession  
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