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)	:	

OBJECTION OF MCI, INC. TO DEBTORS' SECOND AMENDED JOINT PLAN OF REORGANIZATION PURSUANT TO CHAPTER 11 OF THE BANKRUPTCY CODE DATED APRIL 22, 2004

MCI, Inc.[1] and certain of its direct and indirect subsidiaries (collectively, "MCI") hereby object to confirmation of the Debtors' Second Amended Plan of Reorganization to Chapter 11 of the Bankruptcy Code (the "Plan") dated April 22, 2004, filed by Allegiance Telecom, Inc., Allegiance Telecom Company Worldwide ("ATCW"), and ATCW's direct and indirect subsidiaries (collectively, "Allegiance").

GENERAL BACKGROUND

1. MCI adopts and incorporates by reference the objections made regarding the Plan in the Trade Creditors' Objection to Confirmation of Debtors' Second Amended Plan of Reorganization to Chapter 11 of the Bankruptcy Code, filed by the telephone operating company subsidiaries of Verizon Communications Inc. ("Verizon"), KMC Telecom XI LLC ("KMC"),

[1] As the Court is no doubt aware, on July 21, 2002 and November 8, 2002, WorldCom, Inc. and certain of its direct and indirect subsidiaries (the "WorldCom Debtors") commenced cases under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in the Bankruptcy Court for the Southern District of New York (Case No. 02-13533 (AJG). On October 31, 2003, the Bankruptcy Court entered an order confirming the WorldCom Debtors' Modified Second Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code (the "MCI Plan"). On April 20, 2004, the MCI Plan became effective in accordance with its terms, and pursuant to the MCI Plan, Worldcom, Inc. merged with and into MCI, Inc. with MCI, Inc. being the survivor.

BellSouth Telecommunications, Inc. ("BellSouth") and SBC Telecommunications, Inc. (collectively, the "Trade Creditor Group") to the Plan. In addition and as explained more fully below, MCI also objects to the treatment of executory contracts that Allegiance proposes under the Plan.

2. MCI and Allegiance are parties to various executory contracts and agreements, including, *inter alia*: (1) the Asset Purchase Agreement, dated November 30, 2001 (the "IBI Agreement");[2] (2) the Asset Purchase Agreement dated June 17, 2002 (the "STFI Agreement");[3] and (3) the Domestic & Metro Private Line Special Carrier Service Agreement dated September 29, 2000, as amended (the "MSA", and together with the STFI Agreement, the IBI Agreement, and all other tariffs, agreements, and service orders by and among MCI and Allegiance, the "Prepetition Agreements").

3. Prior to the commencement of these chapter 11 cases, MCI and Allegiance sought to resolve and settle certain disputes between them that arose under the Prepetition Agreements. Accordingly, on April 15, 2003, MCI and Allegiance entered into an Agreement for Additional Services, Security, and Settlement of Certain Matters, as amended by Addendum No. 1, dated as of April 15, 2003 (as amended, the "Settlement Agreement"). The Settlement Agreement integrates, amends, and supersedes all prior agreements concerning the subject matter of the Settlement Agreement. One such amendment provides for an extension of the term of the MSA until April 30, 2005.

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[2] Between Allegiance Telecom, Inc., ALGX Business Internet, Inc., WorldCom, Inc., and Intermedia Communications, Inc.

[3] By and among Intermedia Communications, Inc., Shared Technologies Fairchild, Inc., Shared Technologies Fairchild Telecom, Inc., MCI WorldCom Communications, Inc., WorldCom, Inc., Allegiance CPE, Inc., and Shared Technologies Allegiance, Inc.

4. Allegiance must either assume or reject its executory contracts with MCI "before the confirmation of a plan." 11 U.S.C. § 365(d)(2). The Plan, however, ignores this provision by proposing to reject the Settlement Agreement and certain other agreements with MCI several months after the effective date of the Plan.[4] By "rejecting" these agreements months after confirmation, Allegiance seeks to enjoy all of its post-confirmation benefits under the Settlement Agreement while avoiding the obligation to provide any cure of defaults.

5. Further, the Settlement Agreement amends the terms of the MSA and extends its expiration date to April 30, 2005. Because the Initial Effective Date[5] may not occur for several months, the Allegiance scheme would force MCI to continue to perform under an ostensibly rejected agreement until a time when the agreement may expire by its own terms. The Bankruptcy Code does not allow Allegiance to avoid curing defaults under executory contracts by merely extending the effective date of rejection to a time when its executory contracts expire in due course.

6. Moreover, Allegiance must assume or reject its contracts with MCI in whole; it cannot engage in piecemeal rejection of contracts. Although far from clear, the Plan appears to propose rejection of the MSA under Schedule 1 of the Plan (rejection effective as of the Initial Effective Date) while deferring rejection of the Settlement Agreement until at least 180 days after the Initial Effective Date under Schedule 4 of the Plan. The Settlement Agreement, however, integrates and amends the MSA. Allegiance cannot defer rejection of the

[4] Allegiance proposes to reject the Settlement Agreement under Schedule 4 to the Plan. Section 6.1(a) of the Plan specifies that "[c]ontracts and leases listed on Schedule 4 shall be deemed rejected on the later of (i) 180 days after the Initial Effective Date and (ii) the date reflected on Schedule 4 . . . ."

[5] Unless otherwise defined herein, capitalized terms shall have the meanings ascribed to them in the Plan.

benefits it received under the Settlement Agreement while purportedly rejecting other aspects of that agreement on an earlier date to avoid burdens under the MSA.

7. Allegiance must reject or assume the Settlement Agreement (and each of its component terms) by the effective date of the Plan. Because Allegiance fails to comply with the requirements of the Bankruptcy Code, MCI objects to the Plan and requests that the Court deny confirmation.

ARGUMENT

8. Section 1123(b)(2) of the Bankruptcy Code provides that, "subject to section 365 of this title, [a plan] may provide for the assumption, rejection, or assignment of any executory contract . . . not previously rejected under such section." Accordingly, a plan of reorganization can only do so much as section 365 of the Bankruptcy Code allows.

9. When an executory contract is rejected through plan of reorganization under section 1123(b)(2) of the Bankruptcy Code, it is rejected *in toto*; a chapter 11 debtor may not reject undesirable aspects of contract under section 365 while retaining the benefits of the contract. *See, e.g.*, *In re Auto Dealer Services, Inc*., 65 BR 681, 684 (Bankr. M.D. Fla. 1986). This has two implications for the present case. First, Allegiance cannot reject parts of the Settlement Agreement on one date and defer rejection of the remainder to a later date. Second, Allegiance must actually reject the contract when the Court approves the rejection. It cannot continue to retain the benefits of the contracts for months on end without assumption of the agreement.

10. With respect to the first issue, it is well established that under section 365 of the Bankruptcy Code, a debtor must assume or reject an executory contract in its entirety, and executory contracts cannot be dealt with in a piecemeal fashion. *See In re Bildisco & Bildisco*,

465 U.S. 513, 531-32 (1984); *see also In re Cellnet Data Systems, Inc.*, 327 F. 3d 242, 249 (3d Cir. 2003) (stating that under the Bankruptcy Code, a trustee's election to assume or reject is an all-or-nothing proposition -- either the whole contract is assumed or the entire contract is rejected; *In re Plum Run Service Corp.*, 159 B.R. 496, 498 (Bankr. S.D. Ohio 1993) (same). Any other ruling would allow a Debtor to pick and choose portions of the contract it considered profitable, while rejecting any burdens considered onerous.

11. The Settlement Agreement integrates and unifies several predecessor agreements between MCI and Allegiance. For example, the Settlement Agreement expressly provides for the termination date and various purchasing commitments under the MSA. Allegiance cannot sever the MSA from the terms and provisions of the Settlement Agreement in order to arrive at divers rejection dates. As many courts have recognized, multiple contract documents may form one unified agreement. *See, e.g., In re Braniff, Inc.*, 118 B.R. 819, 844 (Bankr. M.D. Fla. 1990) (holding that a separately documented Lease Commitment, Purchase Agreement and Partial Assignment were all part of one unified contract that could not be rejected or assumed "in pieces."). Likewise, the Settlement Agreement reflects a unified agreement between the parties for services delivered under several predecessor agreements. If Allegiance elects to reject the Settlement Agreement, it must do so *in toto* and cannot resort to piecemeal rejection of various components over time.

12. With respect to the second issue referenced above, Allegiance violates section 365 of the Bankruptcy Code by proposing to reject the Settlement Agreement and certain other agreements months after the confirmation of the Plan. Section 365 allows a debtor in possession to "assume or reject an executory contract . . . at any time **before** the confirmation of a plan." 11 U.S.C. § 365(d)(2). If the Bankruptcy Code allowed debtors to reject executory

contracts months after confirmation, it would nullify any incentive debtors have to assume beneficial contracts. Indeed, debtors would simply defer the effective date of rejection until the end of the term (or the desired term). Such a reading of the statute renders the provisions of section 365(b) regarding cure of defaults meaningless.

13. In certain limited circumstances, courts have allowed debtors to reject executory contracts after confirmation. For example, in *In re Gunter Hotel Assoc.*, the Bankruptcy Court for the Western District of Texas considered whether the debtor in that case could "condition the terms of rejection [of a license agreement] so that the effect of rejection would be postponed for approximately sixty days after the effective date of confirmation of the plan." *In re Gunter Hotel Assoc.*, 96 B.R. 696, 697 (Bankr. W.D. Tex. 1988).

14. The *Gunter* court denied the debtor's request to condition the terms of rejection. In reaching this result, the *Gunter* court noted that the debtor's request to condition the effective date of rejection would conflict with "overwhelming case authority that a bankruptcy court is not free to re-write an executory contract" upon rejection. *See id.* at 698 (citing *Leasing Service Corp. v. First Tennessee Bank, N.A.*, 826 F.2d 434, 437 (6th Cir. 1987); *In re Auto Dealer Services, Inc.*, 65 B.R. 681, 684 (Bankr. M.D. Fla. 1986) ("debtor may not reject the undesirable aspects of the contract while claiming the benefits of the contract"); *In re EES Lambert Associates*, 62 B.R. 328, 336 (Bankr. N.D. Ill. 1986) ("a debtor cannot retain those aspects of the contract to his benefit while rejecting the burdensome aspects thereof"); *Matter of Executive Technology Data Systems*, 79 B.R. 276, 282 (Bankr. E.D. Mich. 1987) ("if a debtor elects to reject an executory contract, he rejects the benefits as well as the burdens"); *In re Allain*, 59 B.R. 107, 109 (Bankr. W.D. La. 1986); *In re Silver*, 26 B.R. 526, 529 (Bankr. E.D.Pa. 1983)). Moreover, the court noted that if it approved the motion to reject, the debtor would

necessarily lose all the benefits that had accrued under its license, the counter-party to the license would be relieved of any further duty to perform under the license, and the court could not, and should not "try to blunt that consequence." *Id.*

15. Although the *Gunter* court denied the debtor's attempt to defer rejection for sixty days, it also, *sua sponte*, enlarged the time during which the debtor could reject or assume the contract at issue for sixty days. *In re Gunter*, 96 B.R. at 701. The court enlarged the time for rejection in light of evidence that the debtor was seeking a replacement license, and that sixty days was a reasonable time for the debtor to negotiate and implement such a replacement. Moreover, the court noted that its *sua sponte* action to extend the deadline for assumption or rejection beyond the confirmation hearing "should be granted only rarely." *Id.*

16. In this instance, the rule, not the exception, should apply. First, Allegiance has offered no compelling reason as to why it needs more than six months from confirmation to effect rejection of certain MCI contracts. Indeed, the circumstances facing Allegiance are entirely different from those facing Gunter Hotel. Gunter Hotel faced losing its **only** license with a national hotel chain. *See id.* at 698. Indeed, the court noted that "a national affiliation is all but essential." *Id.* No such exigent circumstances exist before this Court. Allegiance has proposed to assume certain of its telecommunications service contracts and MCI is not the sole provider of such services to Allegiance.

17. MCI submits that Allegiance's proposed rejection of the Settlement Agreement months after the Initial Effective Date has no more validity under applicable law than the "conditioned rejection" before the *Gunter* court. Indeed, the proposed deferral of rejection in that case was a mere sixty days, <u>not six months</u>. In every respect, Allegiance's effort to delay rejection of MCI's Settlement Agreement will serve only to allow Allegiance to continue to

benefit from a rejected agreement without the necessity of curing its defaults thereunder. This "conditioned rejection" stands in direct conflict with section 365 of the Bankruptcy Code and the limited case law that has yet considered such a result.

WHEREBEFORE, MCI respectfully requests that this Court enter an order denying confirmation of the Plan an granting such other and further relief as is just and proper.

Dated: June 1, 2004
Houston, Texas

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