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ATTORNEY FOR THE TEXAS
COMPTROLLER OF PUBLIC ACCOUNTS

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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: CHAPTER 11
:
In re: Allegiance Telecom, Inc., et al : Case No. 03-13057-RDD-11
:
: (Jointly Administered)
Debtors :
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**OBJECTION OF THE TEXAS COMPTROLLER OF PUBLIC ACCOUNTS TO
CONFIRMATION OF THE DEBTORS' AMENDED JOINT PLAN OF
REORGANIZATION**

TO THE HONORABLE ROBERT D. DRAIN, UNITED STATES BANKRUPTCY JUDGE:

The Texas Comptroller of Public Accounts ("Texas Comptroller"), appearing through the Office of the Attorney General of Texas, objects to the Debtors' Amended Joint Plan of Reorganization (the "Plan").

1. The Texas Comptroller has filed priority tax claims against various Debtors in this case in an amount in excess of \$4 million.

2. Pursuant to 11 U.S.C. § 553, setoff rights survive bankruptcy and are not affected by other sections of the Bankruptcy Code, including § 1141. IRS v. Luongo (In re Luongo), 259 F.3d 323 (5th Cir. 2001); Carolco Television, Inc. v. National Broadcasting Co. (In re De Laurentis Entertainment Group, Inc.), 963 F.2d 1269, 1276-78 (9th Cir. 1992), cert. denied, 506 U.S. 918, 113

S. Ct. 330, 121 L.Ed.2d 249 (1992); Davidovich v. Welton (In re Davidovich), 901 F.2d 1533, 1537 (10th Cir. 1990). The Third Circuit has emphasized the importance of raising this issue prior to confirmation in order to avoid an adverse or unintended consequence. United States of America v. Continental Airlines (In re Continental Airlines), 134 F.2d 536 (3d Cir. 1998). Accordingly, the Texas Comptroller requests that the Plan and Confirmation Order be clarified to ensure that its rights of setoff and recoupment are not impaired.

3. Priority tax claims are entitled to receive interest on deferred tax payments under 11 U.S.C. § 1129(a)(9)(C). The interest rate should be a current market rate equivalent to the rate the debtor would have to pay to borrow the same amount in the commercial loan market. In re Lambert, 194 F. 3d 679, 684 (5th Cir. 1999); In re Camino Real Landscape Maintenance Contractors, Inc., 818 F.2d 1503 (9th Cir. 1987); United States v. Neal Pharmacal Co., 789 F.2d 1283 (8th Cir. 1986); In re Southern States Motor Inns, Inc., 709 F.2d 647 (11th Cir. 1983), cert. den., 465 U.S. 1022, 79 L.Ed.2d 680, 104 S.Ct. 1275 (1984). The Plan proposes to use the "underpayment" rate determined pursuant to 26 U.S.C. § 6621. The Plan fails to comply with 11 U.S.C. § 1129(a)(9)(C) because it does not provide for the payment of an adequate rate of interest on priority and secured tax claims. Further, the Plan should provide clearly that interest commences to accrue on or shortly after the confirmation date.

4. The Plan does not contain adequate remedies in the event of a payment default. Default remedy language similar to the following has been approved in many bankruptcy cases:

A failure by the Debtors or reorganized debtors to make a payment to a priority or secured tax creditor pursuant to the terms of the Plan shall be an Event of Default. If the Debtors or reorganized debtors fail to cure an Event of Default as to tax payments within ten (10) days after service of a written notice of default from a tax creditor, then a tax creditor may (a) enforce the entire amount of its claim, (b)

exercise any and all rights and remedies under applicable non-bankruptcy law, and
(c) seek such relief as may be appropriate in this court.

Language similar to the above should be added to the Plan or confirmation order to clarify creditors' default remedies pursuant to 11 U.S.C. § 1123(a)(5)(g), which requires that a plan provide adequate means for the plan's implementation.

5. The Texas Comptroller respectfully requests that the Court waive the requirement contained in Rule 9013-1(b) of the Local Bankruptcy Rules for the Southern District of New York that a separate memorandum of law be submitted with this pleading.

Wherefore, the Texas Comptroller respectfully requests that confirmation be denied and for such other and further relief as may be just.

Respectfully submitted,

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CERTIFICATE OF SERVICE

hereby certify that a copy of the foregoing pleading was sent first class mail, postage prepaid (and by fax where indicated) to the following parties on this 1st day of June, 2004:

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