

Hearing Date: July 24, 2003 at 10:00 a.m.
Objections Due: July 21, 2003 at 4:00 p.m.

KIRKLAND & ELLIS LLP
Citigroup Center
153 East 53rd Street
New York, New York 10022-4675
Telephone: (212) 446-4800
Facsimile: (212) 446-4900
Matthew A. Cantor (MC-7727)
Jonathan S. Henes (JH-1979)

Attorneys for Debtors and Debtors in Possession

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

	X	
In re	:	
	:	Chapter 11 Case No.
Allegiance Telecom, Inc., <u>et al.</u> ,	:	03-13057 (RDD)
	:	
Debtors.	:	Jointly Administered

**MOTION OF THE DEBTORS PURSUANT TO SECTIONS
105 AND 363 OF THE BANKRUPTCY CODE FOR APPROVAL
OF SERVICES AGREEMENT WITH IMPALA PARTNERS, LLC**

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

Allegiance Telecom, Inc. and its direct and indirect subsidiaries, as debtors and debtors in possession (collectively, “Allegiance” or the “Debtors”), respectfully represent:

Introduction

1. On May 14, 2003 (the “Commencement Date”), the Debtors each commenced with this Court a voluntary case under chapter 11 of title 11 of the United States Bankruptcy Code (the “Bankruptcy Code”). The Debtors are authorized to operate their businesses and manage their properties as debtors in possession pursuant to sections 1107 and

1108 of the Bankruptcy Code. The Debtors' chapter 11 cases have been consolidated for procedural purposes only and are being jointly administered pursuant to rule 1015(b) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules").

2. No trustee or examiner has been appointed in these chapter 11 cases. On May 28, 2003, pursuant to sections 1102 of the Bankruptcy Code, the United States Trustee for the Southern District of New York (the "U.S. Trustee") appointed a statutory committee of unsecured creditors (the "Creditors' Committee") in these chapter 11 cases.

Jurisdiction

3. This Court has subject matter jurisdiction to consider and determine this Motion pursuant to 28 U.S.C. § 1334. This is a core proceeding within the meaning of 28 U.S.C. § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

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, wholesale customers 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 colocation services;
- integrated local long distance/Internet access offerings, which provide customers with integrated voice and Internet access over a single broadband line;

- wholesale services to other regional and national service providers, including equipment colocation, managed modem ports and Internet protocol traffic aggregation; and
- customer premise equipment sales and maintenance services.

5. As of the Commencement Date, Allegiance served more than 100,000 business customers in 36 markets. As of the Commencement Date, Allegiance employed approximately 3,560 people, of which approximately 97 employees were covered by collective bargaining agreements.

6. As of the Commencement Date, the Debtors had approximately \$245 million of cash. As of March 31, 2003, the Debtors' consolidated books and records reflected assets totaling approximately \$1.349 billion and liabilities totaling approximately \$1.424 billion. For the three months ending March 31, 2003, the Debtors, on a consolidated basis, reported revenues of approximately \$204.58 million and net losses of approximately \$120.084 million.

The Debtors Decision to Retain a Chief Restructuring Officer

7. Prior to the Commencement Date, the Debtors, in the exercise of their sound business judgment - and in recognition of the distressed economic environment and the need for the Debtors' businesses to focus on profitability instead of high revenue growth - determined that a meaningful de-leveraging of their capital structure was crucial for the preservation and maximization of the value of their businesses. In that regard, the Debtors, in conjunction with their financial advisors (*i.e.* Greenhill & Company) and the Board of Directors of Allegiance, began determining the appropriate capital structure for their business operations. After determining the appropriate capital structure, the Debtors commenced negotiations with their prepetition senior secured lenders (the "Prepetition Lenders") to effectuate a restructuring transaction.

8. In connection with these negotiations, the Prepetition Lenders requested that the Debtors retain a restructuring advisory firm to assist the Debtors in their operational restructuring. After extensive discussions with the Prepetition Lenders and significant internal consideration, the Debtors, after the Commencement Date, determined that retaining the services of such a firm was desirable for three main reasons. First, to minimize disruptions to their business resulting from the commencement of these chapter 11 cases, the Debtors believed that it was critical to allow their senior executives to continue their focus on running the day-to-day operation of the business. In that regard, the Debtors decided that the most advantageous means of achieving this was to retain a firm with restructuring expertise to fill the management role of determining how to best use the bankruptcy process for unnecessary and burdensome costs. Second, the Debtors, through outstanding leadership, have been able to retain the majority of their original management team. While this has provided the Debtors' business with stability and consistency, the Debtors determined that it would be in their best interests to retain outside executives to work at the Debtors on a day-to-day basis and perform an objective analysis of the Debtors' business operations and develop proposals, to be presented to the Special Committee (as defined below), for the future makeup thereof. Third, in these chapter 11 cases, the Debtors seek to achieve a consensual restructuring with their creditor constituencies, but, at the same time, recognize that a successful restructuring will include a substantial reduction of their outstanding indebtedness. A substantial de-leveraging of indebtedness may result in contentious negotiations between the Debtors and certain of their creditor constituencies. Thus, it is critical that the Debtors present their creditor constituencies with comprehensive and thoughtful analyses regarding the projected operating performance of their businesses and ability to service debt, which will provide the basis for the Debtors' need to de-leverage.

9. After making the determination that it was in the best interests of the Debtors and their estates to retain a chief restructuring officer, the Debtors commenced the process of searching for and interviewing appropriate individuals and firms. In that regard, the Debtors located a number of potential candidates, which were based on referrals from the Prepetition Lenders and other parties, to interview for the position. After conducting extensive interviews of each candidate,¹ the Debtors, subject to Court approval, selected Impala Partners LLC (“Impala”) to be the Debtor’s Chief Restructuring Officer. The Debtors selected Impala based on the reasons set forth below.

Information About Impala

10. Impala, which was founded in 1997, is a financial advisory and interim management boutique. Impala specializes in working with companies and creditors in out-of-court workouts and chapter 11 cases. Impala has served as interim managers and financial advisors in financially complex bankruptcies and workouts involving billions of dollars in debt. In that regard, Impala has gained expertise in operating a business through distressed situations and analyzing businesses to determine strategies for both increasing revenue and reducing costs. Representative telecommunication clients include Winstar Communications Inc., Velocite, ICG Communications, Metromedia Fiber Network Services, Inc., and KMC Telecom, Inc.

Relief Requested

11. By this motion, the Debtors request entry of an order, pursuant to sections 105(a) and 363 of the Bankruptcy Code, approving the services agreement (the “Agreement”), dated as of July 11, 2003, between the Debtors and Impala, a copy of which is annexed hereto as

¹ The Prepetition Lenders interviewed the candidates as well.

Exhibit “A.” A summary of the material terms and conditions of the Agreement is set forth herein. Impala’s qualifications, compensation and disinterestedness are set forth in the appended Affidavit of Paul Street (the “Street Affidavit”), attached hereto as Exhibit “B,” filed in support of the Motion.

Services to be Rendered

12. Subject to further order of this Court, the services that Impala will be asked to render to the Debtors are set forth in the Agreement.

13. More specifically, the terms of the Agreement, including the services to be performed, are as follow:²

(a) **Services.** Impala shall serve as the Debtors’ chief restructuring officer and provide advice and information to the Debtors in connection with its restructuring efforts in these chapter 11 cases. Impala shall report to the Debtors’ special restructuring committee of independent directors of the board of directors (the “Special Committee”) and shall include in such reporting those members of management as directed by the Special Committee.

(b) **Term.** The term of the Agreement shall commence on the date of approval of the Agreement by the Bankruptcy Court (the “Effective Date”) and shall continue in full force and effect until first anniversary thereof, subject to either earlier termination or extension of such period by written agreement executed by Impala and the Debtors (the “Term”).

(c) **Compensation for Services.** As compensation for Impala’s services under the Agreement, the Debtors shall pay to Impala a fee of \$ 250,000 for each 30 days work (a “Monthly Fee Payment”), payable in advance. The first payment shall be due by the Debtors and payable to Impala on the Effective Date and each Monthly Fee Payment shall be due and payable 30 days thereafter.

i. As additional compensation for Impala’s services under the Agreement, the Debtors agree to pay, subject to Bankruptcy Approval, to Impala a mutually acceptable success fee (the “Success Fee”). The terms of the Success Fee shall be negotiated between and agreed upon by the Debtors and Impala during the first forty-five days following the Effective Date. If the Debtors and Impala are unable to agree upon the Success Fee within forty-five days of the Effective Date, either party shall have

² To the extent there are any inconsistencies between the summary description of the Agreement contained herein and the terms and conditions of the Agreement, the terms of the Agreement shall control. Any capitalized terms used herein which are not defined herein shall have the meaning ascribed to them in the Agreement.

the right to terminate the Agreement, in which case the Debtors shall have no obligation with regard to the Success Fee. After the Debtors and Impala agree on the Success Fee, but prior to filing an application with the Bankruptcy Court to approve the Success Fee, the Debtors and Impala shall consult with the Prepetition Lenders, the Creditors Committee and the U.S. Trustee, regarding the Success Fee and the justification for the Success Fee. To the extent the Prepetition Lenders, the Creditors Committee and/or the U.S. Trustee have any issues or concerns with respect to the Success Fee, the Debtors and Impala shall, for a period of ten days, attempt to resolve with the Prepetition Lenders, the Creditors Committee and/or the U.S. Trustee, in good faith, such issues and/or concerns. If the Debtors and Impala are not able to resolve such issues and/or concerns with the Prepetition Lenders, the Creditors Committee and/or the U.S. Trustee within such ten day period, Impala may file an application with the Bankruptcy Court to approve the Success Fee on no less than twenty-days notice. Notwithstanding the foregoing, the Success Fee shall be payable in accordance with the requirements of section 330 of the Bankruptcy Code.

(d) **Expense Reimbursement.** In addition to the monthly fee payments and Success Fee, the Debtors agree to reimburse Impala for all reasonable out-of-pocket expenses incurred by Impala in carrying out the terms of the Agreement, including communication charges, travel expenses, copying expenses, delivery and distribution charges, and reasonable fees and expenses of legal counsel that Impala determines is required to advise Impala in connection with carrying out its duties under the Agreement; provided, however, that a request for any such fees and expenses must be filed with the Bankruptcy Court in accordance with the “order establishing procedures for the compensation of professionals” entered therein. All reimbursements shall be made promptly after such payments accrue and are submitted to the Debtors with appropriate documentation for payment hereunder.

(e) **Access to Information.** The Debtors agree to furnish, or cause to be furnished, to Impala such current, historical and projected financial information and other information regarding the business of the Debtors as Impala may request from time to time. The Debtors agree to make available to Impala such representatives of the Debtors, including, among others, directors, officers, employees, outside counsel and independent certified accountants, as Impala may request from time to time. The Debtors represent and warrant to Impala that all such information provided to Impala will be as complete and correct as possible under the circumstances and will not contain any known untrue statements of material fact or omit to state a known material fact necessary in order to make the statements therein not misleading in light of the circumstances under which the statements are made. The Debtors agree to keep Impala advised of all developments materially affecting the Debtors or its financial or legal position. The Debtors represent and warrant to Impala that any projections or other information provided to Impala will have been prepared in good faith and will be based upon assumptions which, in light of the circumstances under which they are made, are reasonable. The Debtors acknowledge and agree that, in rendering its services hereunder, Impala will be using and relying on the information provided to it by the Debtors and its representatives without independent verification by Impala. Impala does not assume responsibility for the accuracy or completeness of any of such information.

(f) **Role as Advisor.** It is hereby agreed by the Debtors and Impala, that in performing its services under the Agreement, Impala is not assuming any responsibility for the Debtors' decision to pursue (or not to pursue) any business strategy or to effect (or not to effect) any transaction. It is further agreed that neither Impala nor any other Indemnified Party (as hereinafter defined) shall be liable to the Debtors or any affiliate of the Debtors in connection with any matter arising out of or relating to the engagement of Impala under the Agreement, or any actions taken or omitted to be taken, services performed or matters contemplated by or in connection with the Agreement, except to the extent that such liability is finally judicially determined to have resulted primarily from the willful misconduct or gross negligence of such Indemnified Party. Impala's primary responsibility is to advise on the operational restructuring of the Debtors, including but not limited to (a) the reduction of costs and increase in efficiencies; (b) the improvement in sales productivity and profitability; (c) management of the "operational bankruptcy task forces"; and (iv) developing the Debtors' long-term business strategy.

(g) **Communications with Creditors.** Impala agrees that the work product it produces shall be shared with the Prepetition Lenders, the Creditors Committee and their respective counsel and advisors (collectively, the "Interested Parties"), subject to appropriate confidentiality measures as it relates to members of the Creditors Committee that are competitors of the Debtors. In addition, as an officer of the Debtors, serving at the pleasure of the Special Committee, Impala shall communicate with the Interested Parties. Impala agrees to (a) maintain a log of all communications, both verbal and written, with the Interested Parties, (b) respond promptly to inquiries made by the Interested Parties and (c) promptly report to the Special Committee regarding all communications with the Interested Parties.

(h) **Confidentiality.** All information provided by the Debtors to Impala will be considered as confidential information and shall be maintained as such by Impala, except to the extent that Impala shall be required to disclose such information pursuant to the laws, rules or regulations of any governmental authority, by compulsion of civil or criminal process or by any court of competent jurisdiction acting pursuant to its powers. It is understood and agreed that confidential information shall not include any information provided by the Debtors to Impala that: (a) is known to Impala prior to disclosure thereof by the Debtors, (b) hereafter becomes, other than through no fault of Impala, generally available to the public, (c) is disclosed to Impala by a third party other than in breach of an obligation of confidentiality owed by such third party to the Debtors, or (d) is independently developed by Impala.

(i) **Termination.** The Debtors or Impala may, at any time, terminate the Term and the Agreement, without liability or continuing obligation, by providing thirty (30) days prior written notice thereof to the other party; provided, however, that except as to the payment of the Success Fee provided in Section 2 of the Agreement, no termination of the Term and the Agreement or expiration of the Term shall affect Impala's right to receive, and the Debtors' obligation to provide: (a) indemnification; or (b) the payments required by the Agreement. To the extent the Agreement is terminated, Impala shall reimburse the Debtors for any payments received that are not yet earned.

(j) **Indemnification.** To the extent consistent with the Debtors obligations to indemnify its officers and directors, the Debtors agree to indemnify and hold harmless Impala and each of its members, managers, officers, agents, employees and controlling persons (within the meaning of the Securities Act of 1933, as amended) (each, an “Indemnified Person”) against any losses, claims, damages or liabilities (or actions or proceedings in respect thereof) brought by any third party (i.e., a person not a party to the Agreement or an Indemnified Party hereunder) arising out of or related to the Agreement, any actions taken or omitted to be taken by an Indemnified Party (including acts or omissions constituting ordinary negligence) in connection with the Agreement and will reimburse each Indemnified Person for all reasonable legal and other expenses as incurred in connection with investigating or defending any such loss, claim, damage, liability, action or proceeding; provided, however, that the Debtors will not be liable in any such case for losses, claims, damages, liabilities or expenses which are finally judicially determined to have resulted primarily from the gross negligence or willful misconduct of any Indemnified Party. In case any proceeding shall be instituted involving any Indemnified Party, such person shall promptly notify the Debtors, and the Debtors, upon the request of the Indemnified Party, shall retain counsel reasonably satisfactory to the Indemnified Party to represent the Indemnified Party and any others the Debtors may designate in such proceeding and shall pay all reasonable fees and expenses of such counsel related to such proceeding. In any such proceeding, any Indemnified Party shall have the right to retain its own counsel at its own expense, except that the Debtors shall pay as incurred the fees and expenses of counsel retained by the Indemnified Party only in the event that (i) the Debtors and the Indemnified Party shall have mutually agreed to the retention of such counsel, or (ii) the named parties to any such proceeding (including any impleaded parties) include both the Debtors and the Indemnified Party and representation of both parties by the same counsel would be inappropriate, in the reasonable opinion of the Debtors, due to actual or potential differing interests between them.

The Debtors will not, without the prior written consent of Impala, settle or compromise or consent to the entry of any judgment in any pending or threatened claim, action, suit or proceeding in respect of which indemnification may be sought hereunder unless such settlement, compromise or consent includes an unconditional release of each party for which indemnification is sought hereunder from all liability arising out of such claim, action, suit or proceeding.

In the event that the indemnity provided for in the Agreement is unavailable or insufficient to hold any Indemnified Party harmless, then the Debtors shall contribute to amounts paid or payable by an Indemnified Party in respect of such Indemnified Party’s losses, claims, damages and liabilities as to which the indemnity provided for in the Agreement is unavailable or insufficient, except for acts of gross negligence or willful misconduct, (i) in such proportion as appropriately reflects the relative benefits received by the Debtors, on the one hand, and Impala, on the other hand, in connection with the matters as to which such losses, claims, damages or liabilities relate, or (ii) if the allocation provided by clause (i) above is not permitted by applicable law, in such proportion as appropriately reflects not only the relative benefits referred to in clause (i) but also the relative fault of the Debtors, on the one hand, and Impala, on the other hand, as well as any other equitable considerations. The amounts paid or payable by a party in respect of losses, claims, damages and liabilities referred to above

shall be deemed to include any reasonable legal or other fees and expenses incurred in defending any litigation, proceeding or other action or claim.

14. Impala's decision to accept its engagement to assist the Debtors is contingent upon Impala's ability to be retained in accordance with terms and conditions of the Agreement, including the indemnification provisions.

15. The services listed above are vital to the success of these chapter 11 cases, and the Debtors require Impala to render such services. The Debtors' believe Impala's involvement with the Debtors' situation will be beneficial and in the best interest of all parties involved and will serve to preserve the estate. Accordingly, the Debtors believe that Impala is well qualified to perform these services and to assist the Debtors in these cases.

Basis for Relief

16. Section 363 of the Bankruptcy Code provides that transactions not in the ordinary course of business must be approved by Court order. Courts within the Second Circuit routinely have held that transactions should be approved under section 363 of the Bankruptcy Code when they are supported by the sound business judgment of management. See, e.g., Comm. of Equity Security Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063 (2d. Cir 1983) (outlining requirements for the sale of assets under section 363(b)). Indeed, bankruptcy courts in this District and other districts have authorized the employment by a debtor of a chief restructuring officer pursuant to section 363 of the Bankruptcy Code. See In re Iridium Operating LLC, et al. Case Nos. 99-45005 CB and 99-45006 CB (Bankr. D. Del. 1999); In re Bill's Dollar Stores, Inc., Case No. 01-0435 (PWJ) (Bankr. D. Del. 2001).

17. Similar management services agreements have been approved by this Court and other courts, pursuant to sections 105 and 363 of the Bankruptcy Code. See, e.g. In re

Metromedia Fiber Network, Inc. (“MFN”), Case Nos. 02-22736 - 02-22742-ASH, 02-22744 - 02-22746-ASH, and 02-22751 - 02-22754-ASH (Bankr. S.D.N.Y. 2002), (a restructuring firm engaged as an independent contractor to serve as the debtors’ Chief Restructuring Officer, a member of the Boards of Directors; and a member of the Executive Committee of the Boards of Directors); In re Malden Mills Indust., Inc., Nos. 01-47214-JBR - 01-47217-JBR (Bankr. W.D. Mass. 2001) (a restructuring firm engaged as Chief Restructuring Officers for debtors).

18. Court approval is warranted here because the Debtors have exercised their sound business judgment in determining that their entry into the Agreement with Impala is in the best interests of their estates and creditors. As indicated herein, Impala is fully skilled and capable of providing the critical services to the Debtors as such are detailed herein and in the Agreement.

Waiver of Memorandum of Law

19. Because there are no novel issues of law presented herein, the Debtors respectfully request that the Court waive the requirement that the Debtors file a memorandum of law in support of this Motion pursuant to rule 9013-1(b) of the Local Bankruptcy Rules for the Southern District of New York.

Notice

20. Notice of this Motion has been provided to (i) the U.S. Trustee, (ii) attorneys for the Prepetition Lenders, (iii) attorneys for the Creditors’ Committee, and (iv) all parties on the Master Service List maintained in these chapter 11 cases. In light of the nature of the relief requested, the Debtors submit that no further notice is required.

No Prior Request

21. No prior motion for the relief requested herein has been made to this or any other court.

WHEREFORE, the Debtors request the Court grant it the relief requested herein and such other and further relief as is just.

Dated: New York, New York
July 11, 2003

Respectfully submitted,

/s/ Jonathan S. Henes
Matthew A. Cantor (MC-7727)
Jonathan S. Henes (JH-1979)
KIRKLAND & ELLIS LLP
Citigroup Center
153 East 53rd Street
New York, New York 10022-4675
Telephone: (212) 446-4800
Facsimile: (212) 446-4900

Attorneys for Debtors and Debtors in Possession