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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
_____	X	

**MOTION OF THE DEBTORS FOR AN ORDER, PURSUANT TO
RULE 9019 OF THE FEDERAL RULES OF BANKRUPTCY PROCEDURE,
APPROVING THE SETTLEMENT AGREEMENT, DATED JULY 15, 2003,
AMONG BAYERISCHE HYPO-UND VEREINSBANK AG, BANK
AUSTRIA CREDITANSTALT CORPORATE FINANCE, INC. AND THE DEBTORS**

TO THE HONORABLE 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 Code (the “Bankruptcy Code”). The Debtors are authorized to operate their business and manage their properties as debtors in possession pursuant to sections 1107(a) 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 1107(a) and 1108 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 pursuant to 28 U.S.C. § 157(b). Venue is proper before this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

An Overview of Allegiance’s Business

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 major markets throughout the United States. As of the Commencement Date, Allegiance employed approximately 3,560 people, of which approximately 97 employees are 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, net losses from operations of approximately \$91.036 million and net losses of approximately \$120.084 million.

Funding Dispute Under Prepetition Credit Agreement

7. Prior to the Commencement Date, Allegiance Telecom Company Worldwide ("ATCW" or the "Borrower") entered into that certain Credit and Guaranty Agreement (the Prepetition Credit Agreement), dated as of February 15, 2000, as amended as of November 27, 2002, among ATCW, as borrower, the Debtors (other than ATCW), as guarantors, certain lender parties thereto (the "Prepetition Lenders") and General Electric Capital Corporation (as successor in interest to Toronto Dominion (Texas), Inc.), as administrative agent (the "Agent"). Two of the Prepetition Lenders are Bayerische Hypo-und Vereinsbank AG and Bank Austria Creditanstalt Corporate Finance, Inc. (collectively, the "Banks").

8. Pursuant to a Funding Notice (as defined in the Prepetition Credit Agreement), dated June 20, 2002 (the “2002 Funding Notice”), the Borrower requested an advance by the Prepetition Lenders of the remaining portion of the then unfunded Revolving Loan Commitments (as defined in the Prepetition Credit Agreement). The Banks declined to fund their respective pro rata share of such unfunded Revolving Loan Commitments. The Banks’ refusal to fund their respective pro rata share of the 2002 Funding Notice resulted in a dispute between the Banks and the Debtors relating to the Banks’ respective obligations under the Prepetition Credit Agreement to honor the 2002 Funding Notice (the “Funding Dispute”).

9. On November 27, 2002, the Prepetition Credit Agreement was amended pursuant to the First Amendment (the “First Amendment”), which was executed by the Debtors and the Requisite Lenders (as defined in the Prepetition Credit Agreement), but not the Banks. Pursuant to Section 7(j) of the First Amendment, the Borrower delivered a written declaration to the Banks (“Defaulting Lender Declaration”), dated January 16, 2003, stating that each of the Banks constituted a Defaulting Lender under Section 2.20 of the Credit Agreement. Pursuant to Section 7(i) of the First Amendment, the Borrower made a voluntary principal prepayment of \$15,000,000 to the Agent and the Agent distributed the proceeds of the voluntary prepayment to those Prepetition Lenders who funded their respective pro rata shares of the Revolving Loan Commitments pursuant to the 2002 Funding Notice (the “Funding Lenders”). Thereafter, the Borrower made a further voluntary principal prepayment of \$5,000,000 to the Agent pursuant to the terms of a Forbearance Agreement, dated April 29, 2003, which was executed by the Debtors and the Requisite Lenders, but not the Banks, and the Agent distributed the proceeds of the voluntary prepayment to the Funding Lenders.

10. The Debtors submit that it is in the best interests of their estates to resolve the Funding Dispute amicably, thereby enabling all parties to the Prepetition Credit Agreement to focus on completing the restructuring of the Debtors as effectively and expeditiously as possible.

Relief Requested

11. By this Motion, the Debtors seek approval, pursuant to Bankruptcy Rule 9019(a), of the terms of the Settlement Agreement and Release, dated as of July 15, 2003 (the “Settlement Agreement”). The salient terms of the Settlement Agreement are as follows:¹

- Within two (2) business days following Court approval of the Settlement Agreement, each of the Banks agrees to advance and deliver directly to the Borrower, which advance will be treated by the Agent for the benefit of the Borrower as provided in the Prepetition Credit Agreement as a Loan (as defined in the Prepetition Credit Agreement), an amount equal to its respective Net Funding Obligation (as defined in the Settlement Agreement) (*i.e.*, an aggregate amount equal to \$7,413,968.90), as full and complete satisfaction of all of the Banks’ payment and funding obligations under the Settlement Agreement and under the Prepetition Credit Agreement.
- Subject only to receipt of Court approval of the Settlement Agreement and receipt by the Borrower of the Net Funding Obligation from each of the Banks,
 - (a) each of the Debtors declares that each of the Banks is a Lender (as defined in the Prepetition Credit Agreement) in good standing and in full compliance with all of the terms of the Prepetition Credit Agreement and all other Credit Documents (as defined in the Prepetition Credit Agreement) and that each of the Banks and each of their respective successors and assigns is entitled to exercise all of the rights and privileges of a Lender in good standing under the Prepetition Credit Agreement and all other Credit Documents to which the Banks or either of them are a party;

¹ The description of the Settlement Agreement is qualified in its entirety by the terms and conditions of the Settlement Agreement, annexed hereto as “Exhibit A.”

- (b) the Borrower rescinds in its entirety the Defaulting Lender Declaration as it may relate to the Banks or either of them and shall deliver to the Agent with a copy to the Banks within one business day of the Court Approval of this Motion a notice in substantially the form set forth in Annex A to the Settlement Agreement, which notice will become effective upon receipt by the Borrower of the Net Funding Obligation from the Banks; and
 - (c) each of the Debtors agrees immediately to cease and desist from, and to use its reasonable efforts to prohibit any other party to the Prepetition Credit Agreement from, referring to or treating either of the Banks, or any subsequent assignee or transferee thereof, as a Defaulting Lender.
- Upon receipt by the Borrower from the Banks of the amount equal to their Net Funding Obligation, the Debtors shall retain the funds as Cash Collateral (as this term is defined in the Amended Final Order) and use such Cash Collateral only in accordance with the terms of the Amended Final Order (as defined in the Settlement Agreement).
- The Debtors and the Banks mutually release, acquit and forever discharge each other and their respective directors, officers, employees, subsidiaries, shareholders, agents, representatives, attorneys, successors and assigns (as well as the Banks' affiliates) from any and all actions, causes of action, suits, claims for sums of money, contracts, controversies, agreements, costs, attorneys' fees, expenses, damages, judgments and demands whatsoever in law or in equity, known or unknown, which the Debtors and the Banks have or may have against any of the released parties (a) with respect to the Debtors, arising out of, under or in connection with the Prepetition Credit Agreement through the date of entry of the Court order approving the Settlement Agreement, including the Banks' respective prior refusals to advance their respective Funding Payment Amount (as defined in the Settlement Agreement) or any other matter relating to the Funding Dispute and (b) with respect to the Banks, arising out of, under or in connection with the Defaulting Lender Declaration through the date of entry of the Court approving the Settlement Agreement.
- The Debtors represent and warrant that none of the Debtors has paid or distributed any amount to the Agent or the Funding Lenders (as defined in the Settlement Agreement) between June 30, 2002 and the date of the Settlement Agreement except (i) the Funding Lender Prepayments (as defined in the Settlement Agreement), (ii) interest due under the Prepetition Credit Agreement paid to the Agent for further distribution to all of the Lenders pro rata to their respective Loans then outstanding and (iii) periodic adequate protection payments authorized under the Interim Order (as defined in the Settlement Agreement) and the Amended Final Order paid to the Agent for further distribution to all of the Lenders pro rata to their respective Loans then

outstanding in amounts equal to the interest payments due and owing under the Prepetition Credit Agreement and other amounts authorized under the Interim Order and the Amended Final Order to be paid the Agent.

- The Agent, in its capacity as Administrative Agent and for itself as a Lender, under the Prepetition Credit Agreement, acknowledges and agrees to the terms and conditions of the Settlement Agreement. Subject only to receipt of Court approval of the Settlement Agreement and receipt by the Borrower of the Net Funding Obligation from each of the Banks, the Agent agrees:
 - (a) that each of the Banks is a Lender in good standing and in full compliance with all of the terms of the Prepetition Credit Agreement and all other Credit Documents and that each of the Banks and each of their respective successors and assigns is entitled to exercise all of the rights and privileges of a Lender in good standing under the Prepetition Credit Agreement and all other Credit Documents to which the Banks or either of them are a party;
 - (b) immediately to cease and desist from, and to use its reasonable efforts to prohibit any other party to the Prepetition Credit Agreement from, referring to or treating either of the Banks, or any subsequent assignee or transferee thereof, as a Defaulting Lender; and
 - (c) to take all reasonable steps to help effect full and unconditional implementation of, all of the terms and conditions set forth in the Settlement Agreement.

12. The Debtors submit that the Settlement Agreement is beneficial to their estates and creditors. The Settlement Agreement resolves all of the outstanding claims between the Debtors and the Banks without the need for protracted and costly negotiations and litigation. In addition, as a result of the Settlement Agreement, the Debtors will receive in excess of \$7.4 million in cash.

The Settlement Agreement Should Be Approved Because It Falls Within the Range of Reasonableness

13. Bankruptcy Rule 9019(a) provides, in relevant part, that: “[o]n motion by the trustee and after notice and a hearing, the court may approve a compromise and settlement.” Compromises and settlements are “a normal part of the process of reorganization.” Protective

Comm. for Indep. Stockholders of TMT Trailer Ferry, Inc. v. Anderson, 390 U.S. 414, 424 (1968) (quoting Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106, 130 (1939)).

14. To approve a compromise and settlement under Bankruptcy Rule 9019, a bankruptcy court should find that the compromise and settlement is fair and equitable, reasonable and in the best interests of the debtor's estate. See, e.g., In re Ionosphere Clubs, Inc., 156 B.R. 414, 426 (S.D.N.Y. 1993), aff'd, 17 F.3d 600 (2d Cir. 1994) (citations omitted); In re Enron Corp., Case No. 02 Civ. 8489, 2003 WL 230838, *2 (S.D.N.Y. Jan. 31, 2003). The decision to approve a particular settlement lies within the sound discretion of the bankruptcy court. Nellis v. Shugrue, 165 B.R. 115, 122-123 (S.D.N.Y. 1994). In exercising its discretion, the bankruptcy court must make an independent determination that the settlement is fair and reasonable. Id. at 122. The court may consider the opinions of the debtor in possession and its counsel that the settlement is fair and reasonable. Id.; see In re Purofied Down Prods. Corp., 150 B.R. 519, 522 (S.D.N.Y. 1993). This discretion should be exercised by the bankruptcy court "in light of the general public policy favoring settlements." In re Hibbard Brown & Co., Inc., 217 B.R. 41, 46 (Bankr. S.D.N.Y. 1998); Shugrue, 165 B.R. at 123 ("the general rule [is] that settlements are favored and, in fact, encouraged by the approval process outlined above").

15. In determining whether to approve a proposed settlement, a bankruptcy court need not decide the numerous issues of law and fact raised by the settlement, but rather should "canvass the issues and see whether the settlement 'fall[s] below the lowest point in the range of reasonableness.'" In re W.T. Grant Co., 699 F.2d 599, 608 (2d Cir. 1983); see also Purofied Down Prods., 150 B.R. at 522 ("the court need not conduct a 'mini-trial' to determine the merits of the underlying [dispute]").

16. In deciding whether a particular settlement falls within the “range of reasonableness,” courts consider the following factors:

- (a) the probability of success in the litigation;
- (b) the difficulties associated with collection;
- (c) the complexity of the litigation, and the attendant expense, inconvenience and delay; and
- (d) the paramount interests of creditors.

Id. (citing Drexel v. Loomis, 35 F.2d 800, 806 (8th Cir. 1989)); Six West Retail Acquisition, Inc. v. Loews Cineplex Entm’t Corp., 286 B.R. 236, 248 n.13 (S.D.N.Y. 2002), see also In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285, 292 (2d Cir. 1992).

17. “The ‘reasonableness’ of a settlement depends upon all factors, including probability of success, the length and cost of the litigation, and the extent to which the settlement is truly the product of ‘arms-length’ bargaining, and not of fraud or collusion.” Ionosphere Clubs, 156 B.R. at 428.

18. In the instant case, the Settlement Agreement is fair and equitable, falls well within the range of reasonableness and enables the parties to avoid the costs of negotiation and litigation. Absent authorization to enter into the Settlement Agreement, the Debtors and the Banks may require judicial intervention to resolve the Funding Dispute. The undertaking of a risky litigation would be an unnecessary drain on the resources of the Debtors’ estates and would divert the attention of its management and legal personnel from the current efforts to maximize the value of the estates. In addition, because the Funding Dispute relates to two of the Prepetition Lenders, without the approval of the Settlement Agreement, the chapter 11 plan negotiations in these chapter 11 cases may be delayed.

19. The value accruing from the Settlement Agreement, including the elimination of potential negotiation and litigation costs and the guarantee of immediate payment of a significant and definite amount, represent a benefit to the Debtors' creditors and all parties in interest. For these reasons, the Court should approve the Settlement Agreement pursuant Bankruptcy Rule 9019.

Waiver of Memorandum of Law

20. 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

21. This Notice has been provided to (a) the U.S. Trustee; (b) attorneys for the Banks; (c) attorneys for the Debtors' prepetition lenders; (d) attorneys for the Creditors Committee and (e) all other parties on the Master Service List maintained in these chapter 11 cases. In light of the nature of the relief requested herein, the Debtors submit that no other or further notice is required.

No Prior Request

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

WHEREFORE, the Debtors respectfully request that the Court enter an order (i) authorizing the Debtors to and (ii) granting such other relief as is just and proper.

Dated: New York, New York
July 17, 2003

Respectfully submitted,

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