

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

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

MOTION FOR AN ORDER PURSUANT TO SECTIONS 105, 363 AND 365 OF THE BANKRUPTCY CODE (i) APPROVING THE ASSUMPTION OF AN UNEXPIRED LEASE OF NONRESIDENTIAL REAL PROPERTY, AS AMENDED, WITH NCX OFFICE DEVELOPMENT, L.P., (ii) AUTHORIZING THE TRANSFER OF PERSONAL PROPERTY FREE AND CLEAR OF LIENS, CLAIMS AND ENCUMBRANCES, (iii) AUTHORIZING THE REJECTION OF EXECUTORY CONTRACTS AND PERSONAL PROPERTY LEASES, AND (iv) AUTHORIZING THE DEBTORS TO ENTER INTO A LETTER OF CREDIT ARRANGEMENT IN CONNECTION WITH THE LEASE AMENDMENT

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

Allegiance Telecom, Inc. and its 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, 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.

2. 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").

3. No trustee or examiner has been appointed in these chapter 11 cases. On May 28, 2003, pursuant to section 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

4. 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

5. The Debtors are facilities-based national local exchange carriers that provide 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. The Debtors offer their 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.
6. As of the Commencement Date, Allegiance served more than 100,000

business customers in major markets throughout the United States. As of June 30, 2003, Allegiance employed approximately 3,300 people, of which approximately 91 employees were covered by collective bargaining agreements.

7. As of June 30, 2003, the Debtors had approximately \$269.2 million of unrestricted cash on hand. As of June 30, 2003, the Debtors' consolidated books and records reflected assets totaling approximately \$1.292 billion and liabilities totaling approximately \$1.459 billion. For the six months ending June 30, 2003, the Debtors, on a consolidated basis, reported revenues of approximately \$401.2 million and net losses of approximately \$212.4 million.

The Allegiance Center

8. The Debtors' principal executive offices are located at 9101 North Central Expressway and 9102 North Central Expressway, Dallas, Texas (collectively, the "Allegiance Center"). The Allegiance Center functions as the Debtors' corporate headquarters where a majority of the Debtors' employees are situated. The Debtors occupy the Allegiance Center pursuant to that certain lease agreement, dated July 19, 2000 (as amended, the "Lease Agreement"), between Allegiance Telecom Company Worldwide ("ATCW"), one of the Debtors in these chapter 11 cases, and NCX Office Development, L.P. ("NCX").

9. Pursuant to the Lease Agreement, ATCW leases approximately 289,807 rentable square feet of space (the “Premises”) in two buildings that are located at 9101 North Central Expressway, Dallas Texas (“Building 1”) and 9201 North Central Expressway, Dallas, Texas (“Building 2”). Specifically, ATCW leases approximately 144,381 square feet of space in Building 1 and approximately 145,426 square feet of space in Building 2. The annual base rent, excluding operating expenses, under the Lease Agreement (without giving effect to Amendment No. 5, which is the subject of the relief requested herein) is approximately \$28.50 per square-foot, for the remainder of the original lease term.

10. Currently, ATCW self-manages the Allegiance Center. In connection with the self-management of the Allegiance Center, ATCW utilizes certain third parties to provide necessary services relating to the Allegiance Center, *e.g.*, building maintenance and cleaning services. The services are governed by numerous executory contracts (the “Contracts”) and unexpired personal property leases (the “Leases”). ATCW’s monetary obligation under the Contracts and Leases is approximately \$29,000 per month.

11. Subsequent to the Commencement Date, the Debtors began analyzing their operational cost structure and determined that they did not need the amount of space rented under the Lease Agreement. Accordingly, the Debtors decided that they could significantly reduce costs if they rejected the Lease Agreement and moved their executive offices to smaller premises with lower rental terms. Consequently, the Debtors determined to seek alternative rental space for their executive offices. To that end, Debtors identified eighty-six (86) alternative properties, toured nine (9) suitable alternatives and received proposals from seven (7) potential landlords, including NCX.

Amendment No. 5 to the Lease Agreement

12. After careful consideration of the various proposals, the Debtors decided to accept – after extensive negotiations – NCX’s proposal that will enable the Debtors to remain at the premises of Building 2 of the Allegiance Center with certain modifications to the Lease Agreement, including (a) a reduction in the space leased by ATCW, (b) a reduction in the per square-foot rent paid by ATCW, (c) a reduction in the lease term by five (5) years and three (3) months and (d) the termination of ATCW’s obligation to self-manage the Allegiance Center.

13. Specifically, subject to this Court’s approval, NCX and ATCW have agreed to amend the Lease Agreement to exclude the leased space in Building 1, to decrease the basic rent per square-foot under the Lease Agreement, to shorten the term of the Lease Agreement, to reduce the common area maintenance costs, and to address certain other related matters, all on the terms and conditions set forth in the Amendment No. 5 to the Lease Agreement, dated as of August 1, 2003 (the “Amendment”). A copy of the Amendment is attached hereto as Exhibit “A.”

14. The Amendment, which is the result of arm’s-length negotiations, provides the terms by which the Debtors will agree to assume the Lease Agreement, as amended, pursuant to section 365 of the Bankruptcy Code. In addition and as described in detail below, the Amendment provides that, subject to Court approval, the Debtors will (a) transfer certain surplus personal property remaining in Building 1 to NCX free and clear of all liens, claims and encumbrances, (b) reject the Contracts and Leases pursuant to section 365 of the Bankruptcy Code and (c) provide a letter of credit to NCX as security for certain potential defaults.

15. Set forth below is a summary of the salient provisions of the Amendment and is qualified entirely by reference to the Amendment itself.¹ The Amendment provides, among other things, as follows:

- a. Space: 145,426 square feet;
- b. Term: 7 years, retroactive to August 1, 2003;
- c. New Base Rent Start Date: Retroactive to August 1, 2003;
- d. Rental Rate: \$17.00 per square-foot (average);
- e. Operating Expenses: 2004 Base Year (estimated at \$8.00 per square foot and included as part of the rental rate) plus electricity (estimated at \$2.00 per square-foot);
- f. Self-Management Termination: ATCW will no longer be responsible for management of the Allegiance Center;
- g. Cure Costs: ATCW has agreed to pay to NCX the amount of \$196,989.09 (the "Cure Amount") to cure all prepetition defaults under the Lease Agreement;
- h. Attorney's Fees: ATCW will pay to NCX \$62,000 in cash as the total reimbursement of ATCW's responsibility for the attorney's fees, court costs and filing fees incurred by NCX in connection with the negotiation, preparation and consummation of the Amendment, and all other documents and transactions related thereto; and
- i. Effectiveness: Upon mortgagee approval, Bankruptcy Court approval, payment of the Cure Amount, and issuance of the letter of credit (as described in detail below).

¹ To the extent there are any inconsistencies or omissions between the summary description of the Amendment contained herein and the terms and conditions of the Amendment itself, the terms of the Amendment shall control.

In addition, the Amendment provides for the following:

- Transfer of Personal Property. In connection with the assumption of the Lease Agreement, as amended, ATCW has agreed to transfer the Debtors' surplus furniture, fixtures, equipment and all other personal property (the "Personal Property") located in Building 1 as of the date of the Amendment to NCX free and clear of any liens, claims and encumbrances pursuant to section 363(f) of the Bankruptcy Code. The Personal Property to be transferred consists of 589 workstations and 675 desk chairs. ATCW estimates that the value of the workstations is \$114,600 and the value of the desk chairs is \$33,750. The transfer of the Personal Property was a portion of the consideration agreed to in connection with the Amendment. Notably, the Debtors do not need the Personal Property for their ongoing operations. In addition, the Debtors have determined that the cost to store, market and sell the Personal Property would exceed the benefit received by ATCW in the reduced rent and other concessions made by NCX under the Amendment.
- Rejection of Contracts and Leases. The Debtors have determined that it is more cost effective to pay operating costs under the Lease Agreement, as amended, to NCX, than to continue self-managing the Premises. As a result, as part of the Amendment, ATCW will no longer be required to self-manage the Allegiance Center. Consequently, ATCW has determined that the Contracts and Leases are no longer necessary or integral to the Debtors' ongoing business operations and will become burdensome to their estates under the terms of the Amendment. By rejecting the Contracts and Leases, the Debtors' estates will realize savings of approximately \$29,000 per month. Accordingly, ATCW requests the approval of the rejection of the Contracts and Leases pursuant to section 365 of the Bankruptcy Code, effective as of the date of the Amendment. The Contracts and Leases are identified in Exhibit "A" to the Amendment annexed hereto.
- Letter of Credit Provisions. In connection with the Amendment, NCX required security for potential defaults thereunder. In that regard, ATCW and NCX agreed that ATCW would obtain a letter of credit for the benefit of NCX. Specifically, ATCW anticipates that JP Morgan Chase Bank ("Chase") will be the financial institution that will issue the LOC. To obtain the LOC, ATCW will pledge cash collateral to Chase (or some other issuing financial institution) in the amount of 105% of the LOC amount to secure the LOC. The Debtors' prepetition senior secured lenders have consented to the use of cash collateral for this purpose. The terms of the LOC are annexed hereto as Exhibit "B".

Relief Requested

16. By this Motion, the Debtors request an order pursuant to sections 105, 363 and 365 of the Bankruptcy Code (a) approving the assumption of the Lease Agreement, as

amended by the Amendment, (b) authorizing the transfer of the Personal Property (as defined below) to NCX free and clear of all liens, claims and encumbrances, (c) authorizing the rejection of the Contracts and Leases as of the effective date of the Amendment, and (d) approving the LOC Provisions (as defined below).

17. In addition, in connection with the LOC, NCX and Chase have required certain protections from the automatic stay under 362 of the Bankruptcy Code. Specifically, because this is a postpetition transaction, and because the issuer and the beneficiary of the LOC are non-debtors, NCX and Chase have requested that the order approving this Motion provide that in the event there is a drawdown under the LOC Provisions, such a drawdown would not violate the automatic stay under 362 of the Bankruptcy Code.

Basis for Relief Requested

Section 365

18. Section 365(a) of the Bankruptcy Code authorizes a debtor in possession to assume or reject an executory contract or unexpired lease subject to the bankruptcy court's approval. *See* 11 U.S.C § 365(a). Section 365(b) of the Bankruptcy Code provides, in pertinent part, that a debtor may not assume an executory contract if there has been a default under such contract unless, at the time of assumption, the debtor cures such default. 11 U.S.C. § 365(b)

19. The standard applied to determine whether the assumption or rejection of an executory contract or unexpired lease should be approved is the "business judgment" test, which is premised on the debtor's business judgment that the assumption or rejection is in its best interest. *See, NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 523 (1984); *Orion Pictures Corp. v. Showtime Networks, Inc. (In re Orion Pictures Corp.)*, 4 F.3d 1095, 1099 (2d Cir. 1993); *Control Data Corp. v. Zelman (In re Minges)*, 602 F.2d 38, 42-43 (2d Cir. 1979).

Assumption of Lease Agreement

20. Some courts have defined the elements of the business judgment standard in the context of an assumption of an executory contract or unexpired lease as whether: (a) the contract or lease is profitable or advantageous to the debtor's estate; (b) the contract or lease is necessary to the continued operation of the business; (c) the contract or lease is necessary to the preservation of estate assets, and (d) the estate will be able to perform its contractual obligations under the contract or lease. *See In re National Sugar Refining Co.*, 26 B.R. 762, 764 (Bankr. S.D.N.Y. 1983); *In re National Sugar Refining Co.*, 26 B.R. 765, 767 (Bankr. S.D.N.Y. 1983); *In re Del Grosso*, 115 B.R. 136, 138 (Bankr. N.D. Ill. 1990).

Rejection of Contracts and Leases

21. In the context of a rejection of an executory contract, upon finding that the Debtors have exercised their sound business judgment in determining that rejection of the contract is in the best interests of the Debtors, their creditors, and all parties in interest, the Court should approve the rejection under section 365(a) of the Bankruptcy Code. *See, e.g., In re Riodizio, Inc.*, 204 B.R. 417, 424 (Bankr. S.D.N.Y. 1997); *In re Bradlees Stores, Inc.*, 194 B.R. 555, 558 n.1 (Bankr. S.D.N.Y. 1996); *In re G Survivor Corp.*, 171 B.R. 755, 757 (Bankr. S.D.N.Y. 1994); *In re Child World, Inc.*, 142 B.R. 87, 89 (Bankr. S.D.N.Y. 1992); *In re Ionosphere Clubs, Inc.*, 100 B.R. 670, 673 (Bankr. S.D.N.Y. 1989).

Section 363(b)

22. Section 363(b)(1) of the Bankruptcy Code provides, in pertinent part, that “[t]he trustee, after notice and a hearing, may use, sell or lease, other than in the ordinary course of business, property of the estate.” 11 U.S.C. § 363(b)(1). To obtain court approval for the purpose of disposing of property, the Debtors must demonstrate a legitimate business justification therefor. *See Comm. of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*,

722 F.2d 1063, 1071 (2d Cir. 1983). In that regard, “[w]here the debtor articulates a reasonable basis for its business decisions (as distinct from a decision made arbitrarily or capriciously), courts will generally not entertain objections to the debtor’s conduct.” *Comm. of Asbestos-Related Litigants v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 60 B.R. 612, 616 (Bankr. S.D.N.Y. 1986). When a valid business justification exists, the law vests the debtor’s decision to use property out of the ordinary course of business with a strong presumption that “in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.” *Official Comm. of Subordinated Bondholders v. Integrated Res., Inc. (In re Integrated Res., Inc.)*, 147 B.R. 650, 656 (S.D.N.Y. 1992) (quoting *Smith v. Van Gorkom*, 488 A.2d 858, 872 (Del. 1985)) *appeal dismissed*, 3 F.3d 49 (2d Cir. 1993).

Section 363(f)

23. The Debtors desire to transfer the Personal Property to NCX free and clear of liens, claims, encumbrances, and interests pursuant to section 363(f) of the Bankruptcy Code. Section 363(f) of the Bankruptcy Code provides:

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if-

- (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
- (2) such entity consents;
- (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
- (4) such interest is in bona fide dispute; or
- (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. § 363(f).

Section 105

24. Further, pursuant to section 105(a) of the Bankruptcy Code, “the court may issue any order, process, or judgment that is necessary to carry out the provisions of this title.” 11 U.S.C. § 105(a). Under section 105(a) of the Bankruptcy Code, the Court has expansive equitable powers to fashion any order or decree that is in the interest of preserving or protecting the value of the Debtors’ assets. *See, e.g., In re Chinichian*, 784 F.2d 1440, 1443 (9th Cir. 1986) (“Section 105 [of the Bankruptcy Code] sets out the power of the bankruptcy court to fashion orders as necessary pursuant to the purposes of the Bankruptcy Code.”); *Bird v. Crown Convenience (In re NAFX, Inc.)*, 864 F.2d 588, 590 (8th Cir. 1988) (“The overriding consideration in bankruptcy . . . is that equitable principles govern”); *In re Cooper Props. Liquidating Trust, Inc.*, 61 B.R. 531, 537 (Bankr. W.D. Tenn. 1986) (“The Bankruptcy Court is one of equity and as such it has a duty to protect whatever equities a debtor may have in property for the benefit of their creditors as long as that protection is implemented in a manner consistent with the bankruptcy laws.”).

Assumption of the Lease Agreement, as Amended, is Warranted

25. The Lease Agreement, as amended, is beneficial to the Debtors’ estates because it reduces the Debtors’ monthly operating expenses and total financial commitments when compared to the terms of the Lease Agreement before the Amendment. Specifically, the Amendment:

- shortens the expiration term of the Lease Agreement from October 31, 2015 to July 31, 2010;
- returns 144,381 rentable square feet to NCX effective August 1, 2003;
- reduces the total average annual rent and operating expenses from \$30.43 per rentable square foot to \$19.66 per rentable square foot for the lease term;

- reduces ATCW's proportionate share of operating expenses as a result of the termination of ATCW's self-management; and
- avoids costly moving expenses.

26. Overall, the Amendment will result in a substantial economic benefit accruing to the Debtors and their estates, estimated at a total savings over the new seven (7) year term versus the existing lease of \$41,827,446 (from August 1, 2003 to July 31, 2010). In addition, the Debtors and their estates will be relieved of \$54,039,121 of existing lease commitments from August 1, 2010 to October 31, 2015.

27. If the Lease Agreement were not assumed as amended, then the Debtors would in all likelihood reject the Lease Agreement. As a result, the Debtors would be required to find new office space and move their corporate, accounting, call center and customer service operations to a new location at an estimated cost of approximately \$750,000. In addition, the Debtors would incur approximately \$1,500,000 to relocate their 10,000 square foot data center presently located at the Allegiance Center. Moreover, the dislocation of the hundreds of the Debtors' employees located at the Allegiance Center would result in a major disruption to the Debtors and their business operations.² Finally, the rejection of the Lease Agreement would result in significant rejection damage claims against the Debtors' estates.

28. As set forth above, prior to the assumption of an executory contract or unexpired lease, a debtor must cure outstanding defaults under such contract or lease. In that regard, ATCW has agreed to pay the Cure Amount of \$196,989.09. Further, NCX and ATCW

² The rental costs savings based on competing offers the Debtors received for alternative space would not have exceeded the cost of disruption of moving to a new location.

have agreed that, except for the payment of the Cure Amount, there are no other defaults under the Lease Agreement that would prevent the assumption of the Lease Agreement.

The Rejection of the Contracts and Leases Should Be Approved

29. As noted above, the Amendment provides that ATCW will no longer be required to self-manage the Allegiance Center. Consequently, the Contracts and Lease are unnecessary and burdensome to the Debtors' estates. As stated above, by rejecting the Contracts and Leases, the Debtors will realize cost savings at \$29,000 per month. Thus, the decision to reject the Contracts and Leases is a product of the Debtors' sound business judgment, and, therefore, the Contracts and Leases should be rejected pursuant to section 365 of the Bankruptcy Code, as of the effective date of the Amendment.

The LOC Provisions Should be Approved

30. The LOC Provisions are an integral component of the Amendment. The LOC Provisions were negotiated at arm's length between the Debtors and NCX. The Debtors believe that the LOC Provisions are standard, reasonable and necessary. In addition, the Debtors agreed that the non-Debtor parties to the LOC may draw down upon the LOC, notwithstanding the automatic stay provisions of section 362 of the Bankruptcy Code. Based on the requirements set forth by NCX (and Chase) with respect to LOC and because the LOC is a prerequisite for entry into the Amendment, the Debtors submit that the LOC Provisions are in the best interest of the estates and should be approved.

The Debtors Should be Authorized to Transfer the Personal Property Free and Clear of all Liens, Claims, and Encumbrances

31. As stated above, the Debtors request that the Personal Property be transferred to NCX, pursuant to section 363(f) of the Bankruptcy Code, free and clear of all liens, claims and encumbrances. The Debtors estimate that the workstations have an aggregate

value of \$114,600 and the chairs have an aggregate value of \$33,750. The transfer of the Personal Property was an important piece of the consideration for the Amendment. The Personal Property is of no value or benefit to Debtors' estates and burdensome insofar as the costs of removal, storage, marketing, and sale of the Personal Property is likely to exceed the net proceeds realizable from their sale.

32. In addition, because section 363(f) is drafted in the disjunctive, satisfaction of any of its five requirements will suffice to approve ATCW's transfer of the Personal Property free and clear of all liens, claims and encumbrances. The Debtors believe that such requirements are satisfied. Other than the liens granted by the Debtors under that certain Credit and Guaranty Agreement, dated as of February 15, 2000, as amended as of November 27, 2002, among ATCW, as borrower; all of the other Debtors, as guarantors; General Electric Capital Corporation (as successor to Toronto Dominion (Texas), Inc.), as administrative agent (the "Agent"), certain other agents, and lenders party thereto from time to time (collectively, the "Prepetition Lenders"), the Debtors are not aware, to the best of their knowledge, of any other liens existing on the Personal Property. On information and belief, the Agent has consented or will consent to the transfer of the Personal Property free and clear of all liens, claims and encumbrances. Thus, the Debtors request that the Personal Property be transferred to NCX free and clear of liens, claims and encumbrances.

33. For the reasons stated above and in the exercise of their sound business judgment, the Debtors believe the relief requested herein is in the best interests of the Debtors, their creditors and their estates.

Waiver of Memorandum of Law

34. This Motion includes citations to the applicable authorities and does not raise any novel issues of law. Accordingly, the Debtors respectfully request 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.

Notice

35. Notice of this Motion has been provided to: (a) the U.S. Trustee; (b) attorneys for the Debtors' prepetition senior secured lenders; (c) attorneys for the Creditors' Committee; and (d) attorneys for NCX; (e) the counter-parties to the Contacts and Lease (and/or their attorneys); and (f) the entities set forth in the Debtors' Master Service List established pursuant to that certain Order Establishing Notice Procedures, dated May 15, 2003. In light of the nature of the relief requested herein, the Debtors submit that no other or further notice is required.

36. No previous request for the relief sought herein has been made by the Debtors to this or any other court.

WHEREFORE the Debtors respectfully request that the Court grant the Motion in all respects and grant the Debtors such other and further relief as it deems just and proper.

Dated: New York, New York
September 15, 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