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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In re:	:	
	:	Chapter 11 Case No.
Allegiance Telecom, Inc., <u>et al.</u> ,	:	03-13057 (RDD)
	:	
Debtors.	:	Jointly Administered
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**SUPPLEMENT TO MOTION OF THE DEBTORS, PURSUANT TO
SECTIONS 105(a), 363(b)(1) AND 365 OF THE BANKRUPTCY CODE,
FOR AN ORDER APPROVING KEY EMPLOYEE RETENTION PROGRAM
AS IT RELATES TO CERTAIN REMAINING KEY EXECUTIVES**

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

Allegiance Telecom, Inc. (“Allegiance”) and its subsidiaries, as debtors and debtors in possession (the “Debtors”) in these chapter 11 cases, by this supplement (the “Supplemental Motion”) to the Original Motion (as defined below) respectfully represent:

Relief Requested

1. By this Supplemental Motion, the Debtors seek authorization to modify the terms and conditions of the Original Retention Program as it relates to the Remaining Key Executives (as defined below) (as amended, the “Modified Executives Retention Program”) and the entry of an order authorizing and approving the Modified Executives Retention Program, as

it relates to both prepetition and postpetition Retention Payments¹ of the Remaining Key Executives.² The Debtors further request (a) authorization to pay the prepetition ordinary course salary amounts due and owing to the Remaining Key Executives above \$4,650 that were not paid pursuant to the Debtors “wages” motion filed on the first day of these chapter 11 cases and (b) the entry of an order approving the Original Motion, as modified by this Supplemental Motion, which provides that the Debtors’ estates and creditors release any and all parties from any and all preference actions, avoidance claims and any other claims that they may have with regard to any Retention Payments (including as revised under the Supplemental Motion).

2. All applicable authority supporting the relief requested herein is set forth in the Original Motion.

Background

3. On August 11, 2003, the Debtors filed a motion (the “Original Motion”) for an order, pursuant to sections 105(a), 363(b)(1) and 365 of the Bankruptcy Code, authorizing and approving a key employee retention program (the “Original Retention Program”) for certain of their employees. The Original Retention Program was implemented by the Debtors prior to the Commencement Date and, thus, included prepetition and postpetition payments. As stated in the Original Motion, the payments due to the following key employees under the Original

¹ Unless otherwise defined herein, all capitalized terms shall have the meaning ascribed to them in the Original Motion.

² The Debtors do not seek the amendment of the Original Retention Program as it relates to Lawrence E. Strickling and Deborah Surrette. The Debtors request that the remaining amount of the Retention Payment for Lawrence E. Strickling be paid on December 31, 2003 and his Retention Agreement be modified to provide that he is required to remain employed by the Debtors, subject to the termination rules set forth in the Original Motion, through the confirmation of a chapter 11 plan of reorganization in these cases in order to keep his Retention Payments. The Debtors have terminated Ms. Surrette’s employment without cause effective as of October 21, 2003. Accordingly, the Debtors request approval of the portion of Ms. Surrette’s Retention Payment made to her prior to the Commencement Date and do not seek authority to pay the remaining portion of Ms. Surrette’s Retention Payment.

Retention Program are secured by letters of credit (the “KERP LCs”) issued by the Debtors prior to the Commencement Date: Royce J. Holland, C. Daniel Yost, Mark B. Tresnowski and Kevin M. Joseph.

4. On August 19, 2003, the Court held a hearing on the Original Motion as it relates to the relief requested with respect to the Priority Key Employees. On August 22, 2003, the Court entered an order approving the Original Motion as it relates to the Priority Key Employees.

5. On September 4, 2003, the Court held a hearing and entered an order (the “Middle Management Order”) approving the Original Motion as it relates to Middle Management (as such term is defined in the Middle Management Order).

6. On September 25, 2003, the Court held a hearing to consider the Original Motion as it relates to the Retention Payments of G. Clay Myers, J. Timothy Naramore, Kevin M. Joseph and Lawrence E. Strickling. Specifically, the Debtors requested authority, with the consent of the Debtors’ prepetition senior secured lenders (the “Prepetition Lenders”) and the statutory committee of unsecured creditors appointed in these chapter 11 cases (the “Creditors’ Committee”) and subject to certain conditions, to approve the payment of 100% of the Retention Payments to G. Clay Myers and J. Timothy Naramore, each of which were made prior to the Commencement Date, and to pay Kevin M. Joseph and Lawrence E. Strickling 25% of their remaining aggregate Retention Payments. On September 29, 2003, the Court entered an order authorizing such payments (the “September 29 Order”).

7. Pursuant to the September 29 Order, the hearing on the Original Motion, as it relates to (a) Royce J. Holland, Thomas M. Lord, Anthony J. Parella, Mark B. Tresnowski and C. Daniel Yost; (b) Deborah Surette, the Vice President of Business Planning of Allegiance

Telecom, Inc. and (c) the remaining aggregate Retention Payments due to Kevin M. Joseph and Lawrence E. Strickling, was adjourned to October 8, 2003.³

8. Subsequent to the filing of the Original Motion, the Debtors, the Prepetition Lenders and the Creditors' Committee engaged in extensive negotiations regarding the appropriate amount of the Retention Payments to be made to certain senior executives, particularly Messrs. Holland, Lord, Parella, Tresnowski, Yost and Joseph (collectively, the "Remaining Key Executives"). Specifically, both the Prepetition Lenders and the Creditors' Committee have requested that the Retention Payments for the Remaining Key Executives be tied to certain metrics based on the current circumstances of these chapter 11 cases.

9. In addition to these negotiations, during the course of these chapter 11 cases, the Debtors commenced discussions with the Prepetition Lenders and the Creditors' Committee regarding certain potential transactions to enable the Debtors to emerge from chapter 11. In that regard, the Debtors and the Prepetition Lenders have agreed on the terms of a stand-alone restructuring plan. However, since such agreement was reached, it has become evident that a sale of the Debtors' businesses, as opposed to a stand-alone restructuring plan, *may* maximize distributable value to the Debtors' creditors. Consequently, the Debtors have commenced a process to consider an alternative sale transaction and determine whether such a sale transaction would realize the highest value for the Debtors' estates as compared to a stand-alone restructuring. The Creditors' Committee and the Prepetition Lenders are in support of this process and the Debtors have been keeping the Creditors' Committee and the Prepetition

³ This hearing was subsequently adjourned to November 7, 2003 pursuant to those certain Notices of Adjourned Hearing filed with the Court on October 3, 2003 and October 21, 2003, respectively.

Lenders apprised of their progress through confidential communications and sharing of information.

10. In view of the unfolding sale process and the uncertainty that an auction of the Debtors' businesses presents to the Debtors' senior executives in terms of their future employment, the Debtors believe that the Original Retention Program needs to be modified to incentivize the Remaining Key Executives to maintain their employment with the Debtors through the confirmation of a chapter 11 plan. In determining the appropriate modifications to the Original Retention Program, the Debtors engaged in significant discussions and negotiations with the Creditors' Committee and the Prepetition Lenders. These discussions and negotiations resulted in a consensual modification of the terms of the Original Retention Program, which was designed to provide the Remaining Key Executives with Retention Payments based on criteria relating to the current status and needs of these chapter 11 cases.

11. Accordingly, the Debtors, with the consent of the Prepetition Lenders and the Creditors' Committee, have amended the Original Retention Program as it relates to the Retention Payments of the Remaining Key Executives,⁴ as set forth in more detail below, and seek Court approval of the Modified Executives Retention Program.

⁴ The Remaining Key Executives Retention Program includes Kevin M. Joseph's retention payments only to the extent of the unpaid amount of \$140,625.

Modified Executives Retention Program

12. Under the Original Retention Program, the Remaining Key Executives were entitled to the following Retention Payments:

Name and Title	Total Amount Subject to Court Approval	Amount of Retention Payments Paid to Date	Unpaid Amount of Retention Payments	Form of Payment
Royce J. Holland (Chairman and Chief Executive Officer)	\$656,000	\$164,000	\$492,000	Cash
Mark B. Tresnowski (Executive Vice President, General Counsel and Secretary)	\$600,000 ⁵	\$375,000 ⁶	\$225,000	Cash
C. Daniel Yost (President and Chief Operating Officer)	\$500,000	\$125,000	\$375,000	Cash
Thomas M. Lord (Executive Vice President and Chief Financial Officer)	\$500,000	\$62,500	\$437,500	Cash
Anthony J. Parella (President, Shared Technologies, Allegiance, Inc.)	\$245,000	\$0	\$245,000	Loan Forgiveness ⁷
Kevin M. Joseph (Senior Vice President of Federal Governmental Affairs)	\$140,625 ⁸	\$359,375 ⁹	\$140,625	Cash
	\$2,641,625 (the "Total Original Amount")			

⁵ This amount includes a special bonus in the amount of \$300,000 which was paid to Mr. Tresnowski prior to the Commencement Date. This amount was not reflected in the Original Motion.

⁶ See footnote 4.

⁷ As disclosed in the Original Motion, Mr. Parella received a loan from one of the Debtors under that certain Full Recourse Promissory Note of Anthony J. Parella and Pledge Agreement between Anthony J. Parella and Allegiance Telecom Company Worldwide, dated November 1, 2001. As further disclosed in the Original Motion, Mr. Parella will use the full amount of his Retention Payment to repay the aforementioned loan.

⁸ This amount only reflects a portion of Mr. Joseph's Retention Payment subject to approval under the Modified Executives Retention Program. The total amount of Mr. Joseph's Retention Payment is \$500,000, of which \$359,375 has been already paid.

⁹ This amount includes a special bonus in the amount of \$250,000 which was paid to Mr. Joseph prior to the Commencement Date. This amount was not reflected in the Original Motion.

13. The Modified Executives Retention Program provides for the Retention Payments in the aggregate amounts set forth in the chart below, which amounts are based on the total consideration distributed to the Debtors' creditors under a plan of reorganization confirmed in these chapter 11 cases:

Total Consideration Distributed to the Debtors' Creditors Under a Chapter 11 Plan of Reorganization	Aggregate Amount of Retention Payments Under the Modified Executives Retention Program ¹⁰	Percentage as it Relates to the Total Original Amount
\$430.0 million or less	\$1,320,812.50	50%
From above \$430 million to \$473 million	\$1,584,975.00	60%
From above \$473 million to \$478.2 million	\$1,849,137.50	70%
From above \$478.2 million to \$490 million	\$2,113,300.00	80%
From above \$490 million to \$510 million	\$2,245,381.25	85%
From above \$510 million to \$530 million	\$2,377,462.50	90%
From above \$530 million to \$550 million	\$2,509,543.75	95%
From above \$550 million to \$570 million	\$2,641,625.00	100%
From above \$570 million to \$580 million	\$2,773,706.25	105%
From above \$580 million to \$590 million	\$2,905,787.50	110%
From above \$590 million to \$600 million	\$3,037,868.75	115%
From above \$600 million to \$610 million	\$3,169,950.00	120%
From above \$610 million to \$620 million	\$3,302,031.25	125%
From above \$620 million to \$640 million	\$3,434,112.50	130%
From above \$640 million to \$660 million	\$3,566,193.75	135%
From above \$660 million to \$680 million	\$3,698,275.00	140%
From above \$680 million to \$700 million	\$3,830,356.25	145%
From above \$700 million to \$720 million	\$3,962,437.50	150%
From above \$720 million to \$740 million	\$4,094,518.75	155%
Above \$740 million		Additional 5% for each incremental \$20 million of value above \$740 million

14. Under the Modified Executives Retention Program, the Remaining Key Executives will be entitled to receive the remaining amount of their Retention Payments on the

¹⁰ Each of the Remaining Key Executives will be entitled to receive his pro rata portion of the amount set forth in this column.

date of confirmation of a plan of reorganization in these chapter 11 cases. The Debtors intend on amending the retention agreements of the Remaining Key Executives to require that they must remain employed by the Debtors through the date of confirmation of a plan of reorganization, subject to termination rules set forth in the Original Motion, in order to be eligible to receive the Retention Payments. If a Remaining Key Executive resigns for any reason prior to the date of confirmation of a plan of reorganization, the Remaining Key Executive will be obligated to repay the net amount of any Retention Payments received prior to such resignation. In addition, the Remaining Key Executives, whose benefits under the Original Retention Program are secured by the KERP LCs, have agreed to surrender the KERP LCs upon entry of an order approving this Supplemental Motion. The Debtors will cancel the KERP LCs upon their surrender.

The Modified Executives Retention Program Should be Approved

15. The Debtors have determined that the modification of the Original Retention Program, as it relates to the Remaining Key Executives, and approval of the Modified Executives Retention Program is in the best interests of the Debtors, their estates, creditors and all parties in interest.

16. In making this determination, the Debtors submit that, in light of the recent developments in these chapter 11 cases, the services and retention of the Remaining Key Executives are more critical than ever to the Debtors' successful emergence from chapter 11. Moreover, based on the commencement of the current potential sale process, the future employment of the Remaining Key Executives is at risk. Thus, if the Debtors do not obtain Court approval of the Modified Executives Retention Program, the Remaining Key Executives may commence the process of seeking other employment opportunities and/or terminate their employment with the Debtors to pursue such employment opportunities. Consequently, the

Debtors have determined that due to the current uncertainties faced by the Remaining Key Executives, the Modified Executives Retention Program will serve as an incentive for them to remain with the Debtors during the duration of these chapter 11 cases and to negotiate and consummate a transaction, through a sale or stand-alone restructuring, that will maximize recoveries for the Debtors' creditors.

17. In addition, Kirkland & Ellis LLP, as attorneys for the Debtors, consulted with a representative of the U.S. Trustee's Office, the attorneys for the Prepetition Lenders and the attorneys for the Creditors' Committee regarding the relief requested herein. *All* of the aforementioned parties have consented to such relief.

18. The Debtors submit that the approval and authorization of the Modified Executives Retention Program is absolutely essential to the Debtors' continued operations and restructuring efforts. Accordingly, the relief requested herein should be approved.

Notice

19. Notice of this Supplemental Motion has been provided to (a) the U.S. Trustee; (b) attorneys for the Prepetition Lenders; (c) attorneys for the Creditors Committee and (d) 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.¹¹

No Prior Request

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

¹¹ Notably, to date, the Debtors have not received any objections to the Original Motion or the relief requested therein.

WHEREFORE the Debtors respectfully request that the Court enter orders substantially in the form annexed hereto (i) granting the Original Motion, as modified by this Supplemental Motion; (ii) approving and authorizing the Modified Executives Retention Program and (iii) granting the Debtors such other and further relief as it deems just and proper.

Dated: New York, New York
November 5, 2003

Respectfully submitted,

/s/ Jonathan S. Henes

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