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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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In re: : Chapter 11
: :
ALLEGIANCE TELECOM, INC., *et al.*, : Case No. 03-13057 (RDD)
: :
Debtors. : (Jointly Administered)
: :
: :
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**PROVISIONAL MOTION OF WORLDCOM, INC. AND ITS DEBTOR
AFFILIATES FOR RELIEF FROM THE AUTOMATIC STAY
WITH RESPECT TO A CERTAIN LETTER OF CREDIT**

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

WorldCom, Inc. and certain of its direct and indirect subsidiaries
(collectively, "WorldCom") respectfully represent:

Preliminary Statement

1. WorldCom is the beneficiary to a letter of credit (the "LOC"), dated April 28, 2003, that was issued by JPMorgan Chase Bank (the "Issuer"). The Issuer provided WorldCom with the LOC upon the request of its customer, Allegiance Telecom, Inc. or certain of its affiliates (collectively, "Allegiance" or the "Debtors").

Allegiance procured the LOC in connection with a settlement agreement entered into with WorldCom during the administration of WorldCom's cases under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code") in this District. As described in detail below, the LOC secures payment for telecommunications services rendered by WorldCom to Allegiance.

2. Courts in this District, as well as elsewhere, overwhelmingly agree that relief from the stay imposed by section 362 of the Bankruptcy Code (the "Automatic Stay") **is not** required in order to draw on a letter of credit. Accordingly, WorldCom submits this Motion as a prophylactic measure. Most likely, this Court will agree that relief from the Automatic Stay is unnecessary under the facts presented. Nevertheless, out of an abundance of caution and, in the event that the Court determines that the Automatic Stay somehow applies, WorldCom requests relief from stay to the extent necessary to permit it to take the steps necessary to draw on the LOC.

Background

3. On July 21, 2002 and November 8, 2002, WorldCom, Inc. and substantially all of its direct and indirect domestic subsidiaries commenced cases under chapter 11 of the Bankruptcy Code (the "WorldCom Bankruptcy") in the Bankruptcy Court for the Southern District of New York, Case No. 02-13533 (AJG) (the "WorldCom Court"). WorldCom continues to operate its businesses and manage its properties as debtor in possession.

4. After the commencement of the WorldCom Bankruptcy, both WorldCom and Allegiance alleged claims and disputes against the other that arose, *inter alia*, from the various contracts and tariffs between the parties. For example, WorldCom

asserted claims against Allegiance in an informal complaint with the Federal Communications Commission relating to the historic interstate access rates charged to WorldCom by Allegiance. On the other hand, Allegiance asserted numerous pre-petition claims against WorldCom, including indemnification claims of approximately \$11 million for alleged breaches of warranties, representations and covenants arising under a certain Asset Purchase Agreement, dated November 30, 2001 (the “IBI Agreement”).¹ Allegiance also notified WorldCom that it intended to assert indemnification claims against WorldCom for alleged breaches of warranties and representations under a certain Asset Purchase Agreement, dated June 17, 2002 (the “STFI Agreement”).²

5. In order to resolve these disputes and claims, among others, WorldCom and Allegiance entered into an Agreement for Additional Services, Security, and Settlement of Certain Matters, as amended by Addendum No. 1, dated as of April 15, 2003 (as amended, the “Settlement Agreement”). On May 2, 2003, WorldCom filed its Motion pursuant to Bankruptcy Rule 9019 seeking an Order approving the Settlement Agreement (the “Settlement Motion”). On May 29, 2003, the WorldCom Court entered an Order granting the Settlement Motion and approving the Settlement Agreement in its entirety.

6. As contemplated in the Settlement Agreement, on April 28, 2003, Allegiance provided the LOC from the Issuer to WorldCom. *See* Declaration of Natalie

¹ Between Allegiance Telecom, Inc., ALGX Business Internet, Inc., WorldCom, Inc., and Intermedia Communications, Inc.

² By and among Intermedia Communications, Inc., Shared Technologies Fairchild, Inc., Shared Technologies Fairchild Telecom, Inc., MCI WorldCom Communications, Inc., WorldCom, Inc., Allegiance CPE, Inc., and Shared Technologies Allegiance, Inc.

Bannister, annexed hereto as Exhibit 1 (the "Bannister Decl."). The LOC names WorldCom as sole beneficiary thereunder, and expires on April 30, 2005. *See id.* Allegiance provided the LOC in the amount of \$3,000,000.00, as security for purchases of services and products by Allegiance from WorldCom ("Services"), including, but not limited to, those products and services provided pursuant to prior agreements between the parties, tariff, under the Settlement Agreement, or pursuant to new agreements. Annexed hereto as Exhibit 1-A is a true and correct copy of the form of LOC issued pursuant to the Settlement Agreement.

7. Allegiance and WorldCom continue to provide Services to each other under the Settlement Agreement. *See the Bannister Decl.*

8. On May 14, 2003, Allegiance filed petitions for relief under chapter 11 of the Bankruptcy Code. As of May 14, 2003, Allegiance owed WorldCom approximately \$5,990,915.29 in the aggregate for Services rendered under the Settlement Agreement. *See id.*

9. Allegiance has pending disputes with respect to certain amounts owed to WorldCom as of May 14, 2003. In addition, Allegiance has claimed certain credits in order to reduce the amounts owed to WorldCom. After subtracting the credits claimed by Allegiance, and all disputed charges, the undisputed amount owed is \$1,404,295.77 (the "Undisputed Charges"). *See id.* Annexed hereto as Exhibit 1-B is a detailed schedule of the Undisputed Charges.

10. WorldCom has the right to draw upon the LOC if Allegiance fails to pay WorldCom undisputed amounts for Services within 60 days after the receipt by Allegiance of an invoice and upon 15 days prior written notice to Allegiance of

WorldCom's intention to draw upon the LOC. It has been more than sixty days from the date of receipt by Allegiance of the invoices for the Undisputed Charges. *See id.*

Jurisdiction

11. This Court has jurisdiction to consider this matter pursuant to 28 U.S.C. § § 157 and 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.

Requested Relief

12. As previously discussed, WorldCom submits that it may draw on the LOC to satisfy the Undisputed Charges without implicating the Automatic Stay. Indeed, the overwhelming majority of courts in this District and elsewhere have concluded just that. Accordingly, WorldCom simply wants a clarification that this Court will not consider its attempt to draw on the LOC to be in violation of section 362 of the Bankruptcy Code.

13. During informal discussions between the parties, Allegiance did not agree that WorldCom could draw upon the LOC. Therefore, out of an abundance of caution, WorldCom requests that this Court, pursuant to section 362(d)(1) of the Bankruptcy Code, modify the automatic stay, if necessary, to permit them to do so.

14. Moreover, as WorldCom has taken the precautionary step of bringing this matter to the Court's attention through this Motion, WorldCom requests that the Court permit it to treat this Motion as WorldCom's fifteen day prior written notice of intent to draw on the LOC in the amount of the Undisputed Charges.

Basis for Relief

**WorldCom's Request To Draw On
The LOC Does Not Implicate The Automatic Stay**

15. It is well-settled among courts that a letter of credit and the proceeds therefrom are not property of the debtor's estate under section 541 of the Bankruptcy Code. See *Matter of Compton Corp.*, 831 F.2d 586, 589 (5th Cir. 1987); *In re Zenith Laboratories, Inc.*, 104 B.R. 667 (Bankr. D. N.J. 1989); *In re W.L. Mead, Inc.*, 42 B.R. 57 (Bankr. N.D. Ohio 1984); *In re Leisure Dynamics, Inc.*, 33 B.R. 171 (Bankr. Minn. 1983); *In re North Shore & Central Illinois Freight Co.*, 30 B.R. 377 (Bankr. N.D. Ill. 1983); *In re M.J. Sales & Distribution Co.*, 25 B.R. 608 (Bankr. S.D. N.Y. 1982). These courts reason that when an issuer honors a proper draft under a letter of credit, it does so from its own assets and not from the assets of its customer who caused the letter of credit to be issued. *Id.* Because the letter of credit and its proceeds are not property of the debtor's estate, they are not subject to the automatic stay. See *In re War Eagle Const. Co., Inc.*, 283 B.R. 193, 200 (S.D.W. Va. 2002); .

16. The Bankruptcy Courts for the Southern District of New York agree with the majority rule that a letter of credit obtained by a debtor and issued by a bank does not call for the payment of any of the debtor's property and is not subject to the stay. See, e.g., *In re Skylark Travel, Inc.*, 120 B.R. 352, 354 (Bankr. S.D.N.Y. 1990) (“The second point raised by the debtor that ARC violated the automatic stay imposed under 11 U.S.C. § 362(a) when it redeemed the letter of credit posted by the debtor is also without weight because when a bank honors a letter of credit it pays the beneficiary with its own funds and not with assets belonging to the debtor who caused the letter of credit to be issued.”); *In re M.J. Sales & Distributing Co.*, 25 B.R., at 613-15 (holding same).

17. The overwhelming weight of case law (including the cases in this District) plainly support the conclusion that WorldCom will not violate the automatic stay by drawing on the LOC. Accordingly, WorldCom requests that the Court allow it to draw on the LOC for the Undisputed Charges as no property of the estate will be effected by this request.

**Even If The Automatic Stay Is Implicated,
These Circumstances Warrant Relief From Stay**

18. Section 362(d) of the Bankruptcy Code provides as follows:

On the request of a party in interest and after notice and a hearing, the court shall grant relief from the stay . . . by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest; [or]

(2) with respect to a stay of an act against property under subsection (a) of this section, if –

(A) the debtor does not have equity in such property; and

(B) such property is not necessary to an effective reorganization.

A secured creditor seeking relief from the automatic stay has the burden to show the debtor's lack of equity under section 362(d)(2)(A). However, the debtor bears the burden of proof with respect to all other issues under section 362(d). *See* 11 U.S.C. § 362(g); *see also Sonnax Industries, Inc. v. Tri Component Products Corp. (In re Sonnax Industries, Inc.)*, 907 F.2d 1280, 1285 (2nd. Cir. 1990).

a. Cause

19. Section 362(d)(1) of the Bankruptcy Code authorizes bankruptcy courts to grant any party in interest relief from the automatic stay for “cause”. 11 U.S.C. § 362(d)(1). “Neither the statute nor the legislative history defines the term “for cause” and the legislative history gives only very general guidance.” *In re Sonnax*, 907 F.2d at 1285. Thus, the “facts of each request will determine whether relief is appropriate under the circumstances.” *Mazzeo v. Lenhart (In re Mazzeo)*, 167 F.3d 139, 142 (2nd Cir. 1999) (citing *In re Sonnax*, at 1286, quoting H.R. Rep. No. 95-595, at 343-44 (1977)).

20. The general test for determining whether cause exists to modify the stay involves balancing the harm that will be caused to the parties if the stay remains in effect or is modified. *See In re C & S Grain Co.*, 47 F.3d 233, 238 (7th Cir. 1995) (“In determining whether cause exists, the bankruptcy court should base its decision on the hardships imposed on the parties with an eye towards the overall goals of the Bankruptcy Code.”). Among the other factors identified by the courts to be considered in determining whether cause exists to modify the stay are: (a) whether relief would result in resolution of the issues; (b) whether lifting the stay would interfere with the bankruptcy case; (c) whether litigation in another forum would prejudice the debtor’s other creditors; (d) considerations of judicial economy; and (e) whether the parties are ready for trial in the nonbankruptcy proceeding. *Prindle v. Countryside Manor, Inc. (In re Countryside Manor, Inc.)*, 188 B.R. 489 (Bankr. D. Conn. 1995); *see also Milne v. Johnson (In re Milne)*, 185 B.R. 280 (N.D. Ill. 1995); *Burger Boys, Inc. v. South Street Seaport Ltd. Partnership (In re Burger Boys, Inc.)*, 183 B.R. 682 (S.D.N.Y. 1994); *IRS v. Robinson (In re Robinson)*, 169 B.R. 356 (E.D. Va. 1994); *United States v. Northland Assocs., Inc (In*

re Abrantes Constr. Corp.), 132 B.R. 234 (N.D.N.Y. 1991), *In re Touloumis*, 170 B.R. 825 (Bankr. S.D.N.Y. 1994) (all applying identical or substantially similar standards). After the movant makes an initial showing of cause, the burden of proof rests on the debtor to show that cause does not exist. *See, e.g., In re Sonmax*, 907 F.2d at 1285.

21. As discussed above, the Issuer, not the Debtors, are obligated under the LOC for payment of WorldCom's Undisputed Charges. Moreover, as reflected in Exhibit 1-A hereto, all payments from the Issuer are made from its own funds. As a result, Allegiance faces no harm whatsoever if the stay is lifted in these circumstances. Assuming that the Court permits WorldCom to proceed against the LOC as requested herein, the only consequence to Allegiance would be a *possible* change in the identity of its creditors. In other words, the Issuer may have a corresponding indemnification claim for the amount of the draw under its contract with Allegiance, but this claim will not affect assets of the estate because the Automatic Stay will operate to stay that claim. *See Lower Brule Const. Co. v. Sheesley's Plumbing & Heating Co., Inc.*, 84 B.R. 638, 645 (D.S.D. 1988).

22. By contrast, WorldCom and other similarly situated creditors face significant hardship if they are unable to rely on the independence of a letter of credit to ward against credit risk. Courts have endorsed "the principle that a letter of credit is a separate contract, independent of the underlying obligations or transactions that gave rise to its issuance, and that strict adherence to this principle is necessary to protect the integrity of letters of credit as a valuable commercial tool." *In re Prime Motor Inns, Inc.*, 130 B.R. 610, 613 (S.D. Fla. 1990) (citing *Pro-Fab, Inc. v. Vipa, Inc.*, 772 F.2d 847 (11th Cir. 1985); *East Girard Savings Ass'n v. Citizens Nat'l Bank and Trust Co. of Baytown*,

593 F.2d 598 (5th Cir. 1979); *In re Air Conditioning, Inc. of Stuart*, 72 B.R. 657 (S.D. Fla. 1987)). WorldCom has chosen to contract with the Issuer based on this principle. Allowing the Automatic Stay to impede letters of credit would pose a significant hardship to WorldCom and the legion of other creditors that look to letters of credit for protection against credit risks.

23. Due to the fact that a draw on the LOC will have no material adverse effect on Allegiance or these bankruptcy cases, and will create a significant hardship for WorldCom, the stay should be modified to the extent necessary to permit WorldCom to exercise its rights against the LOC.

b. Allegiance Has No Equity in the LOC and any Interest Allegiance May Have in LOC is not Necessary to an Effective Reorganization.

24. Out of an abundance of caution, WorldCom requests that, to the extent the Debtors' estates have any interest in the LOC that may be protected by the automatic stay, the automatic stay be modified to permit WorldCom to draw on the LOC. Courts have granted similar relief with respect to property in which the debtor has only a tangential or nominal interest. *See, e.g., United Jersey Bank v. CS Associates (In re CS Associates)*, 121 B.R. 942 (Bankr. E.D. Pa. 1990) (indenture trustee entitled to relief from stay to utilize cash account funded by debtor to secure bond-payment obligations where debtor's interest in account was that of a settlor of a trust); *Chase Manhattan Bank v. Walt Robbins, Inc. (In re Walt Robbins, Inc.)*, 129 B.R. 452 (Bankr. E.D. Va. 1991) (party was entitled to relief from stay to foreclose against property in which debtor held only legal title; estate derived no benefit from debtor's limited rights in property); *In re Jones*, 121 B.R. 122 (Bankr. M.D. Fla. 1990) (same).

25. As discussed above, the LOC is an agreement between non-debtor parties. Further, WorldCom is the sole beneficiary under the LOC. Thus, Allegiance lacks even a contingent interest in the available funds. Accordingly, it is inconceivable that the Debtors could have any equity in the proceeds of the LOC. Assuming, *arguendo*, that Allegiance might possibly have some residual or contingent interest (which it does not), the value of the LOC does not exceed the amount that Allegiance owes to WorldCom under the Settlement Agreement. Consequently, WorldCom is under-secured and Allegiance lacks any equity in such funds.

26. Given that Allegiance has no equity in the LOC, Allegiance has the burden to demonstrate that any interest Allegiance has in the LOC is necessary to an effective reorganization. *See* 11 U.S.C. § 362(g). Because Allegiance does not have any right to use the LOC, Allegiance cannot meet its burden to show that any interest it may have in the LOC is necessary to an effective reorganization. *See, e.g., In re Continental Airlines, Inc.*, 134 B.R. 536 (Bankr. D. Del. 1991).

27. In *In re Hernando Healthcare, Inc.*, 157 B.R. 701 (Bankr. M.D. Fla. 1993), an indenture trustee moved for relief from the automatic stay to withdraw \$2.5 million from a reserve fund. The reserve fund was indirectly funded with the proceeds of the bond issuance. The debtors did not have any right to utilize the funds until the bonds and other secured obligations were satisfied. Although not wishing to adopt a *per se* rule that a *de minimis* interest in property is a basis for lifting the automatic stay, the court found this limited reversionary interest to be insufficient to deny relief from the automatic stay. *Id.* at 704. In granting relief from the automatic stay, the court noted, “[here], Debtors have a very limited equity in the [reserve fund]. Debtors’

utilization of the [reserve fund] is minimal, and utilization of the [reserve fund] for reorganization is likewise minimal.” *Id.* In the case of the LOC, Allegiance does not even have a reversionary interest in those funds. Consequently, there are no reasons why the stay should not be lifted to permit WorldCom to draw on the LOC. *See also In re Continental Airlines, Inc.*, 134 B.R. 536 (Bankr. D. Del. 1991) (creditor was entitled to relief from stay under section 362(d)(2) to foreclose on funds established with proceeds of bond sale where debtor had no equity in funds and debtor failed to show funds were necessary for an effective reorganization).

28. Attached hereto as Exhibit 1 is the Declaration of Natalie G. Bannister in support of the Motion of WorldCom for Relief from Automatic Stay.

Memorandum of Law

29. Pursuant to Local Bankruptcy Rule for the Southern District of New York 9013-1(b), because there are no novel issues of law presented herein, WorldCom respectfully requests that the Court waive the requirement that it file a memorandum of law in support of this objection.

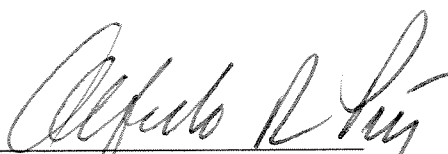
Notice

30. Notice of this Motion has been provided (a) the U.S. Trustee; (b) attorneys for the Debtors’ prepetition lenders; (c) attorneys for the Creditors’ Committee; (d) the Debtors; and (e) all the other parties on the Master Service List maintained in these chapter 11 cases. WorldCom submits that no other or further notice need be provided.

31. No previous motion or application for the relief sought herein has been made to this or any other Court.

WHEREFORE, WorldCom respectfully requests that this Court enter an order (i) treating this Motion as the required fifteen days prior written notice of such intent to draw on the LOC in the amount of the Undisputed Charges; (ii) clarifying that the Automatic Stay is inapplicable to WorldCom's intent to draw on the LOC in the amount of the Undisputed Charges; or (iii) modifying the automatic stay to the extent necessary to permit WorldCom to draw on the LOC in the amount of the Undisputed Charges; and (iv) granting WorldCom such other and further relief as is just.

Dated: New York, New York
December 12, 2003



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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

**ORDER GRANTING PROVISIONAL MOTION OF WORLDCOM, INC. AND
ITS DEBTOR AFFILIATES FOR RELIEF FROM THE AUTOMATIC STAY
WITH RESPECT TO A CERTAIN LETTER OF CREDIT**

Upon the motion (the “Motion”) dated December 12, 2003 of WorldCom, Inc. and its debtors affiliates (collectively, “WorldCom”) seeking provisional relief from the automatic stay pursuant to section 362(d) of chapter 11 of title 11 of the United States Code (the “Bankruptcy Code”) to permit WorldCom to provide notice of its intent to draw on a certain letter of credit, dated April 28, 2003 (the “LOC”), issued by JPMorgan Chase Bank to WorldCom as sole beneficiary, and to permit WorldCom to draw on the LOC in the amount of the Undisputed Charges,¹ as described more fully in the Motion; and the Court having jurisdiction to consider the Motion and the relief requested therein in accordance with 28 U.S.C. §§ 157 and 1334; and due and proper notice of the Motion having been provided, and it appearing that no other or further notice need be provided; and the Court having reviewed the Motion, the papers in support thereof, and the

¹ Capitalized terms not otherwise defined herein shall have the meaning ascribed to such terms in the Motion.

responses thereto, if any; and upon the Motion, and all of the proceedings had before the Court; and the Court having found and determined that the legal and factual bases set forth in the Motion establish just cause for the relief granted herein; and after due deliberation and sufficient cause appearing therefor, it is

ORDERED that Motion is granted; and it is further

ORDERED that notice of the Motion is hereby deemed to constitute good and sufficient fifteen days prior written notice of WorldCom's intent to draw on the LOC in the amount of the Undisputed Charges; and it is further

ORDERED that the automatic stay is hereby lifted to the extent necessary to permit WorldCom to draw on the LOC in the amount of the Undisputed Charges; and it is further

ORDERED that the requirement pursuant to Local Rule 9013-10(b) that WorldCom file a memorandum of law in support of the Motion is waived.

Dated: New York, New York
January __, 2004

United States Bankruptcy Judge