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ATTORNEY FOR THE TEXAS
COMPTROLLER OF PUBLIC ACCOUNTS

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

-----X
: Chapter 11
:
In re: Allegiance Telecom, Inc., et al., : Case No. 03-13057 (RDD)
:
: (Jointly Administered)
Debtors :
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**TEXAS COMPTROLLER'S OBJECTION TO MOTION
TO APPROVE BIDDING PROCEDURES AND NOTICE**

The Texas Comptroller of Public Accounts ("Texas Comptroller"), appearing through the Office of the Attorney General of Texas, objects on the following grounds to the Debtors' motion to establish bidding procedures for a sale of substantially all of the Debtor's assets and to approve the form and manner of notice related to the proposed asset sales (the "Motion"):

1. The Motion continues a disturbing trend in proposed § 363 sales in large Chapter 11 cases: through improper notice and deception, attempting to obtain tax exemptions that are not warranted under the Bankruptcy Code and controlling Supreme Court precedent.

2. It is established beyond dispute that "bankruptcy sales" of assets are subject to state sales and use tax laws. California Board of Equalization v. Sierra Summit, Inc., 109 S.Ct. 2228 (1989).

3. Bankruptcy Code § 1146(c) refers only to "a stamp tax or similar tax" in providing a potential tax exemption for transactions under a plan confirmed under Section 1129. Section 1146(c) does not apply to sales or use taxes or other taxes that are not "stamp taxes or similar taxes."

In re 995 Fifth Avenue Associates, L.P., 963 F.2d 503 (2d Cir. 1992).

4. The Motion makes no reference to "sales or use taxes," referring only to "transfer taxes." Attached to the Motion is a proposed sale agreement that, in Section 6.10(a), refers to making "commercially reasonable efforts" (not, notably, "good faith" efforts) to have included in a sale order a provision that the contemplated transactions are "free and clear of any stamp or similar taxes under section 1146(c)."

5. Buried, however, within the 10-page definitions section of the 68-page, single-spaced Asset Purchase Agreement (transmitted in two parts due to its length) attached as Exhibit D to the Motion is an attempt to define Transfer Taxes to include "sales [and] use" taxes. This is transparent effort to obtain by deception, subterfuge and improper notice unwarranted relief that counsel (acting subject to Bankruptcy Rule 9011) know or should know is unwarranted as a matter of law. In addition to the clear Supreme Court holding in Sierra Summit that bankruptcy sales are subject to sales and use taxes, 28 U.S.C. §§ 959(b) and 960 affirmatively obligate debtors in possession to comply with state tax laws while in bankruptcy, not evade them.

6. This attempt to obtain unwarranted relief by subterfuge and lack of proper notice is far from the first such effort to be attempted in a Chapter 11 megacase. State taxing authorities, having grown frustrated with repeated "gotcha" tactics by debtors' counsel in this area, are increasingly taking steps to prevent this form of distant-forum abuse and transparent Rule 9011 violation. The Texas Comptroller and Texas Attorney General's Office have implemented a "fair warning" policy to address this recurring type of abuse of the bankruptcy system. That policy involves pointing out to Debtors' counsel that they have sought unwarranted relief and asking that counsel voluntarily withdraw the offending provisions from proposed sale documents. In most instances to date, counsel

have complied and agreed to follow the law. Debtor's counsel, though so advised, has failed to respond.

7. The attempt to bury tax exemptions in the fine print of lengthy exhibits to § 363 sale motions, with inadequate or misleading notice in motions themselves, closely resembles efforts by Chapter 13 practitioners to bury unwarranted tax relief or discharge relief in the fine print of Chapter 13 plans. See, e.g., In re Luarks, 301 B.R. 352 (Bankr. D. Kan. 2003), where in an unhighlighted footnote to a Chapter 13 plan, Debtor's counsel inserted a provision that would have allowed the debtor to escape paying the interest portion of priority tax claims. The Court refused to give binding effect to the resulting confirmation order, noting that "the intentional insertion of a plan provision that bypasses clear and unambiguous language of the Bankruptcy Code and controlling case law is unacceptable, and potentially sanctionable." Id. at 359. A similar procedural sleight-of-hand was attempted in In re Ruehle, 296 B.R. 146 (Bankr. N.D. Ohio 2003), where a Chapter 13 debtor, despite clear rules provisions requiring an adversary proceeding to be filed to obtain a hardship discharge of student loan debt, slipped a discharge provision in a plan, attempting to bind unsuspecting student loan creditors without adequate notice. The court harshly rejected the effort, noting that deliberate failure to comply with Bankruptcy Rules or provide due process "strikes at the core of American legal values." 296 B.R. at 164. The court continued:

'The history of American freedom is, in no small measure, the history of procedure.' Malinowski v. New York, 324 U.S. 401 ... (1945)(opinion of Frankfurter, J.) That quote doesn't just sound good. It's true.... [W]e must not engage in complex rationalizing to dignify a denial of fundamental rights. Due process is not to be sliced, diced and disguised with sauce. Due process must be served whole, without garnish.

8. Debtors' counsel here have done the same thing in a Chapter 11 context and should be

similarly admonished or sanctioned, particularly after receiving fair warning that the offending provision should be removed. Such conduct is unethical and disappointing from a firm with the reputation of Kirkland and Ellis, which should not, in handling major Chapter 11 cases in New York City, stoop to the level of unethical small-time Chapter 13 lawyers.

Wherefore, the Texas Comptroller requests that any attempt to expand Section 1146(c) to cover sales and use taxes be stricken from the proposed sale documents and any order with respect to the Motion, and that the Texas Comptroller have such other relief to which it may be entitled, including appropriate procedures to prevent a recurrence of the sanctionable conduct of Debtors' counsel in this case.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing pleading was served by first class mail, postage prepaid on the following parties on this 31st day of December, 2003:

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