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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

_____)	
In re)	
ALLEGIANCE TELECOM, INC., <i>et al</i> ,)	Chapter 11 Case No.
Debtors.)	03-13057 (RDD)
_____)	
	Jointly Administered

**MOTION OF K.M. COMPLEX, L.P. FOR AN ORDER PURSUANT TO
SECTION 365(d)(4) OF THE BANKRUPTCY CODE SETTING SEPTEMBER 20, 2003
AS THE DATE BY WHICH DEBTOR MUST ASSUME OR REJECT
UNEXPIRED LEASE OF NONRESIDENTIAL REAL PROPERTY**

K.M. Complex, L.P. (“Landlord”), a landlord of the debtor CTSnet, Inc. (together with the other debtors-in-possession in this administratively consolidated proceeding, the “Debtor”), hereby requests that the Court issue an order establishing September 20, 2003 as the date by which the Debtor must assume or reject the Debtor’s lease with the Landlord (the “Lease”) covering approximately 28,000 square feet of space (the “Premises”) at the property commonly

known as the Kearny Mesa Complex, San Diego, California. As grounds for this Motion, Landlord states that a potential replacement tenant has submitted a proposal to Landlord to lease almost half of the Premises, including the space used by the Debtor, for a ten year term commencing December, 2003 (well beyond the Lease termination date of October 31, 2005), and at a rental rate only slightly less than that payable by the Debtor under the Lease. However, the proposal is contingent on the prospective tenant's ability to access the Premises by December 1, 2003, and the new tenant has required that it be informed of the availability of the space by October 1, 2003, so that it may begin to make arrangements to move its business to the Premises. Thus, the Landlord is certain to lose the potential tenant if the Debtor is not required to assume or reject the Lease by September 20, 2003.

It is overwhelmingly likely that the Debtor will eventually reject the Lease – indeed, the Debtor has informed the Landlord that it will likely do so unless the Landlord agrees to substantial Lease modifications which the Landlord is not prepared to accept. The Debtor currently occupies less than 1,000 square feet, or 3.5% of the Premises, and, on information and belief, makes very limited use of this space it does occupy.

If the Landlord loses its current re-letting opportunity, and the Lease is then rejected by the Debtor, the Landlord will be damaged beyond compensation available under the Bankruptcy Code. The Landlord will not only be forced to find a new tenant in a very difficult market, but its resulting unsecured rejection claim would be subject to the limitations set forth in Section 502(b)(6) of the Bankruptcy Code. Thus, the potential harm to the Landlord arising from the failure to secure the new tenancy is quite real, and vastly outweighs the burden on the Debtor from being compelled to assume or reject the Lease by September 20, 2003.

For these reasons, and for the additional reasons set forth below, the Landlord requests that the Court fix September 20, 2003 as the date for Debtor to assume or reject the Lease.

An Affidavit of Todd Pearlman, National Leasing Director for Yale Properties, USA, Inc., which, in part, oversees the leasing for the Premises, accompanies this Motion.

Factual and Procedural Background

1. On or about October 4, 1995, Landlord and Debtor's predecessors-in-interest executed a "Standard Industrial/Commercial Multi-Tenant Lease-Gross" for approximately 1,868 square feet of commercial space in a building complex owned by the Landlord located at Complex Drive, San Diego, California, and known as the Kearny Mesa Complex. The Lease provides for the Debtor to use the 1,868 square feet to "[h]ous[e] [] networking equipment and support/technical personnel as allowed under existing zoning." Affidavit of Todd Pearlman ("Pearlman Affidavit"), ¶ 3.

2. Between January 10, 1996 and July 18, 2002, Landlord and Debtor modified the Standard Industrial/Commercial Multi-Tenant Lease-Gross fourteen times, pursuant to amendments dated January 10, 1996, August 1, 1996, September 18, 1996, April 9, 1998, July 13, 1998, February 9, 1999, May 21, 1999, September 13, 1999, February 10, 2000, May 16, 2000, October 27, 2000, November 1, 2000, March 1, 2001 and July 18, 2002. *Id.*, ¶ 4. These amendments increased the square footage of the Premises that the Debtor leased from the Landlord at the Kearny Mesa Complex to 28,491 square feet. *Id.*, ¶ 3. At present, the monthly base rental under the Lease is \$42,694.46, or approximately \$1.50 per square foot. *Id.*, ¶ 5. That rent is scheduled to increase another eight times during the remaining term of the Lease, to a maximum base rental of \$49,788.15 per month commencing on August 1, 2005. *Id.* The Lease expires on October 31, 2005, with one three-year extension option available to the Debtor. *Id.*

The obligations of CTSnet under the Lease are guaranteed by Allegiance Telecom, Inc., pursuant to a Guaranty of Lease dated November 1, 2000. Id.

3. The Debtor's active use of the Premises has steadily dwindled to a point where, upon information and belief, it occupies only 1,000 square feet of the Premises. Id., ¶ 7. On information and belief, CTSnet uses the limited space it occupies within the Premises for equipment that routes internet service provider ("ISP") traffic generated by its California customers to other facilities. Id. On information and belief, the level of ISP traffic routed through the Premises is quite low, and the Debtor's ISP business is not significant to the overall business operations; the Debtor's primary business is that of a local exchange carrier. Id.

4. On or about December 25, 2002, the Debtor and Trion Technologies, Inc. executed a sublease for approximately 3,589 square feet of the Premises (the "Sublease"). Id., ¶6. The Sublease term expires on the earlier of October 31, 2005, or the termination of the Lease. Id.¹

5. Pursuant to Section 365(d)(4) of the Bankruptcy Code, the Debtor was obligated to assume or reject the Lease by July 13, 2003. On July 2, 2003, acting upon a motion filed by the Debtor, the Court issued an order (the "Extension Order") extending the Debtor's time to assume or reject the Lease through January 14, 2004. See Extension Order dated July 2, 2003, a copy of which is attached as Exhibit A. The Order provides that this extension is "without prejudice to the right of any lessor under [an] Unexpired Lease [] to move the Court to fix an earlier date by which the Debtor[] must assume or reject [the] Unexpired Lease [] pursuant to section 365(d)(4) of the Bankruptcy Code." The Order further provides that the Debtor "shall

¹ Although the Lease required the Landlord's consent to the Sublease, such consent was not obtained by the Debtor. Specifically, the Landlord conditioned its consent on the Debtor's payment of approximately \$75,000 in repair expenses for which the tenant is responsible under the Lease. Although the Debtor agreed to pay this amount to the

maintain the burden of persuasion as to why the time within which the Debtor may assume or reject [the Lease] shall continue through January 14, 2004,” if any lessor requests that the Court fix an earlier date for such action. Id. Thus, under the Order, the filing of this Motion requires that the Debtor be treated as having sought an extension of time to assume or reject the Lease beyond September 20, 2003; furthermore, the Debtor has the burden to justify this request.

6. On various occasions since the Debtor commenced this case, the Landlord has been in contact with representatives of the Debtor concerning the possible assumption or rejection of the Lease. See Pearlman Affidavit, ¶¶ 8, 11. The Debtor has informed the Landlord that it will likely reject the Lease absent a substantial reduction in the rent payable thereunder, and a reduction of 50% or more in the size of the Premises. Id., ¶ 8. The Landlord is not willing to modify the Lease as requested by the Debtor. Id.

7. In anticipation of the Debtor’s rejection of the Lease – particularly in light of its stated intention to do so absent substantial lease modifications, and its current use of only a fraction of the Premises – the Landlord has been testing the market for a successor tenant for the Premises. The Landlord has received a proposal to lease approximately 13,000 square feet of the Premises, including that portion of the Premises currently occupied by the Debtor. Id., ¶ 9. The proposal is for a term of ten years commencing on December 1, 2003, and provides for a base rental rate comparable to that contained in the Lease. Id. However, the prospective tenant has made it clear that it will not execute a lease for any portion of the Premises unless it can be assured of its ability to move into the space by December 1, 2003. Id. The prospective tenant has required that any issues arising out of the Debtor’s current occupancy of the Premises be finally resolved no later than October 1, 2003. Id.

Landlord, it never did so – and Trion thereafter moved into the space covered by the Sublease without the

8. If the date for the Debtor to assume or reject the Lease remains January 14, 2004, the Landlord will lose the prospective tenant. Id., ¶ 10. In light of the economic downturn and its particularly adverse impact on the real estate market for telecommunications facilities, it will be extremely difficult for the Landlord to procure another prospective tenant or terms as favorable as those contained in the current proposal if the Debtor determines to reject the Lease. Id.

9. If the Landlord is permitted to re-let the Premises, the Debtor will benefit in numerous respects. It will be relieved of the obligation to pay rent on 27,000 square feet of space it is not now using. Further, the Landlord's rejection claim will be substantially mitigated by the rent received from the new tenant. For these reasons, the setting of an early date to assume or reject the Lease is not only fair to the Landlord, it is in the best interests of the Debtor's creditors.

Argument

The Debtor Cannot Show Cause As To Why The Date To Assume Or Reject The Lease Should Be Extended Through January 14, 2004

10. Balancing the needs of the Landlord and the Debtor, this Court must conclude that an extension of time to assume or reject the Lease beyond September 20, 2003 would be improper. The resulting harm to the Landlord far outweighs the benefit of providing the Debtor with an additional four months to decide if it should continue to pay rent on 27,000 square feet it does not use. Given that it uses only 1,000 square feet of the Premises, the Debtor's decision respecting the Lease is obvious. In reality, the Debtor could probably lease this amount of space elsewhere in the San Diego area at a rate that is less than it currently pays under the Lease. Indeed, the Debtor has already told the Landlord that it will likely reject the Lease unless it

Landlord's consent having been obtained.

receives substantial concessions that the Landlord is not prepared to give.

11. If the Debtor rejects the Lease by September 20, 2003, and the Landlord reaches agreement with the prospective tenant, the Debtor and the Debtor's creditors will benefit from the mitigation of the Landlord's claim. Allowing the extension, however, will assure the loss of Landlord's prospective long-term tenant, and would likely expose the Landlord to damages beyond compensation available under the Bankruptcy Code.

A. The Debtor bears the Burden of Showing that Cause Supports a Further Extension of Time to Assume or Reject the Lease

12. Pursuant to the Extension Order, the Debtor is deemed, by virtue of this Motion, to have requested an extension of time to assume or reject the Lease, pursuant to §365(d)(4), to January 14, 2004. The Extension Order also makes clear that the Debtor bears the burden of persuasion and must show cause as to why this Court should extend the time for it to assume or reject the Lease. See also In re Wedtech Corporation, 72 B.R. 464, 469 (Bankr. S.D.N.Y. 1987) (burden of proof is on Debtor to show cause for an extension under §365(d)(4)); In re Muir Training Technologies, Inc., 120 B.R. 154, 158 (Bankr. S.D. Cal. 1990) (same). Courts balance various criteria in determining whether a debtor has shown cause including whether 1) the lease is a primary asset of the debtor 2) the landlord has a reversionary interest in a building built by the tenant on the landlord's land and, thus, the gaining of a building would represent a windfall to the landlord 3) the Debtor has had sufficient time to appraise its financial situation and the value of its assets and 4) the landlord will sustain damage beyond compensation available under the Bankruptcy Code through the debtor's continued occupation of the land and failure to pay taxes. Id. at 471-472; Theatre Holding Corp. v. Mauro, 681 F.2d. 102, 105-106 (1996); In re

Muir Training Technologies, Inc., 120 B.R. 154, 158 (Bankr. S.D. Cal. 1990).² Here, these factors weigh decidedly against extending the date for the Debtor to assume or reject the Lease through January 14, 2004.

B. The Landlord Will Sustain Damage Beyond Compensation Available Under The Bankruptcy Code If The Extension Of Time Is Permitted

13. Extending the Debtor's time to assume or reject the Lease to January 14, 2004 is likely to damage the Landlord beyond the compensation available under the Bankruptcy Code. The Landlord will lose a potential tenant who is willing to rent almost half of the Premises at a rate per square foot that is not much less than the rent payable under the Lease. Given the likelihood of the Debtor's eventual rejection of the Lease, the Landlord will later face the daunting task of securing one or more tenants in an unfavorable real estate market.

Opportunities to obtain tenants as favorable as the prospective tenant could well be few, if any. Finding another new tenant at a rent comparable to that set forth in the Lease could be difficult, if not impossible.

14. Once the Debtor rejects the Lease – which it has apparently determined to do and which, in light of its monthly carrying costs and the Debtor's use of less than four percent of the Premises, is highly likely in any event – the Landlord will be left only with its unsecured rejection claim, which will be “capped” at one year's rent pursuant to 11 U.S.C. 502(b)(6) (limiting a lessor's recovery against a debtor to the rent reserved by their lease for the greater of one year, or fifteen percent of the remaining term of the lease not to exceed three years). 11

² Courts also consider the following factors in determining whether the Debtor has shown cause: 1) whether the lessor continues to receive rental payments and whether the Debtor has failed to pay rent reserved in the lease; 2) whether the case is exceptionally complex and involves a large number of leases; 3) whether the need exists for judicial determination of whether the lease is a disguised security agreement; and 4) any other factors bearing on whether the debtor has had a reasonable amount of time to decide to assume or reject the lease. In re Muir Training Technologies, Inc., 120 B.R. 154, 158 (Bankr. S.D. Cal. 1990) citing In re Wedtech Corporation, 72 B.R. at 471-472.

U.S.C. §502(b)(6). Even if the Debtor successfully reorganizes, the Landlord's prospects of receiving full payment of its capped claim are minimal; its recovery on the portion of its claim exceeding the Section 502(b)(6) cap will be zero.

15. Furthermore, even if the extension is granted and the Debtor is somehow able to fulfill its obligations under the Lease through October 31, 2005, the Landlord will lose the benefit of the remaining eight years of the proposed new lease term. In light of the Section 502(b)(6) cap, the damages to Landlord from this lost opportunity can never be recovered by the Landlord.

16. In sum, extending the deadline for the Debtor to assume or reject the Lease through January 14, 2004 will unduly burden the Landlord, and cause it damage for which it will undoubtedly receive minimal compensation from the Debtor. This Court should not sanction such a result. The likelihood of substantial prejudice to the Landlord from an extension significantly weighs against a finding that the Debtor has satisfied its burden of persuasion pursuant to 11 U.S.C. §365(d)(4) and the Extension Order.

C. The Lease Is Not A Primary Asset Of The Debtor

17. There is nothing unique about the Premises that is necessary to the continued operation of debtor's business. Compare In re Wedtech Corporation, 72 B.R. 464, 469 (Bankr. S.D.N.Y. 1987) (allowing extension for debtor to assume or reject lease at issue, in part, because lease appeared to be principal asset of the debtor; debtor used building on leased premises as a research and development facility for a highly sophisticated coating process and for the manufacture of products used in this process.); In re 611 Sixth Avenue Corp., 191 B.R. 295 (Bankr. S.D.N.Y. 1996) (allowing extension for debtor to assume or reject lease at issue, in part, because of determination that the lease was the debtor's primary asset; debtor had invested

considerable amounts to construct a restaurant on the premises which debtor operated). Instead, the Premises is merely one of 132 locations leased by the Debtor at the time of its bankruptcy filing. There is no evidence that the Debtor's facility at the Premises is more than one of numerous facilities in the Debtor's telecommunications network, that it is critical to its operation, and that it is not capable of relocation in any event. Indeed, on information and belief, the Premises is currently used only for the limited purpose of routing low levels of ISP traffic – itself not a core part of the Debtor's business – generated by its California customers. Thus, it is likely that the elimination of the Premises from the Debtor's network will have no meaningful impact on its business or reorganization efforts.

18. Furthermore, the Debtor currently uses less than *four percent* of the Premises for its business purposes. Even taking the Sublease into consideration, the Debtor's total use of the Premises barely totals twenty percent of the space. The carrying costs for 23,000 feet of unused space – based on the current rent rate under the Lease, over \$34,000 per month – surely outweighs any benefit gleaned by the Debtor of retaining the Lease. Indeed, it is likely that the cost of relocating to and refitting a smaller space is likely to be far less than the rent the Debtor pays monthly for a significant amount of unused space. Given the soft telecommunications real estate market, the rental rate for comparable space will probably be no more than the Debtor's rate under the Lease.

19. Accordingly, it is apparent the Lease is not a primary asset of the Debtor. In reality, the Debtor's continued occupancy of the Premises is a burden, since the Debtor is paying for a significant amount of space that it does not use or derive any benefit from. The Debtor cannot rely on the importance of the Premises to its business operations to justify an extension of time to assume or reject the Lease.

D. The Landlord Has No Reversionary Interest In A Building Built By The Debtor On The Premises

20. This is not a case where the Debtor has financed the construction of new building on the Premises. Compare In re Wedtech Corporation, 72 B.R. 464, 466 (Bankr. S.D.N.Y. 1987) (allowing extension for debtor to assume or reject lease at issue, in part, because debtor built the building and financed improvements on the leased premises at issue.) Although the Debtor has made modifications to a portion of the Premises, it is unlikely that the rejection of the Lease would result in any benefit or windfall to the Landlord. Indeed, depending on the nature of the alterations and the build-out required by a new tenant, their removal or further alteration may in fact result in additional cost to the Landlord. Since the Landlord has no significant reversionary interest in buildings on or material improvements to the Premises made by the Debtor, there will be no windfall to Landlord resulting from the Debtor's rejection, adding further support to Landlord's request to fix September 20, 2003 as the deadline for the Debtor to assume or reject the Lease.

E. No Additional Time Is Necessary For The Debtor To Appraise The Value Of The Lease

21. As noted above, commercial space is likely available to the Debtor in the San Diego area at reduced or equivalent cost. Thus, the Lease is of no particular value to the Debtor's bankruptcy plan formulation. See In re Muir Training Technologies, Inc., 120 B.R. 154 (Bankr. S.D. Cal. 1990) (denying debtor's motion for extension of time to assume or reject lease; lease at issue was of no particular value to the debtor's plan, in light of the availability of comparable rental space at or below market rates near the debtor's place of business). Indeed, as the Debtor has apparently already determined, the Lease is a financial burden to the Debtor. As noted above, the Debtor is using its limited resources to make monthly payments on the Lease,

while at the same time using less than four percent of this space for a non-core, low-traffic business. Even with the sublease, the Debtor is paying rent on approximately 24,000 square feet of the Premises – roughly 80% of the total – which is completely unused. At current rent rates – they will continue to increase during the remainder of the Lease term – this translates to a monthly carrying cost of over \$34,000 for empty space. It is no surprise, then, that the Debtor has already informed the Landlord that it will likely reject the Lease absent substantial Lease modifications.

22. The Debtor has had more than sufficient time to draw the obvious conclusion that the Lease is simply an impediment to its reorganization plan and not a vital asset. Indeed, the Debtor has already informed the Landlord that it will likely reject the Lease. Thus, there is simply no cause for extending the deadline to assume or reject the Lease through January 14, 2004.

F. The Debtor's Rejection Of The Lease By September 15, 2003 Will Mitigate The Landlord's Damages And Benefit The Debtor, Its Creditors And The Landlord

23. The fact that the Landlord, the Debtor and its creditors will benefit by the Debtor's rejection of the Lease on September 20, 2003 is no small consideration, and weighs further against finding cause for extending the Debtor's assumption or rejection deadline. See In re Ernst Home Center, Inc., 209 B.R. 974, 981 (Bankr. W.D. Wash. 1997) (the "test for 'cause' under § 365(d)(4) leaves a great deal of discretion to the Court to weigh all relevant factors related to the requested extension.") As discussed above, if the Debtor promptly rejects the Lease, it will enable the Landlord to enter a new lease with the prospective tenant for almost half of the Premises at close to the same rate currently paid by the Debtor. This will have the effect of mitigating any potential claim the Landlord has against the Debtor, this reducing its rejection

damage claim. This reduction will, of course, be of significant benefit to the Debtor's creditors, – yet another factor in favor of setting September 20, 2003 as the deadline to assume or reject the Lease.

G. A Five-Day Period to Assume or Reject the Lease Is Neither Burdensome Nor Prejudicial to the Debtor

24. In an attempt to avoid litigation over this matter, the Landlord has been in regular contact with the Debtor respecting the potential new lease, and the assumption or rejection of this Lease. Indeed, the Debtor has been aware of the potential new lease since early August, 2003, and agreed to inform the Landlord of its final decision respecting the assumption or rejection of the Lease by the end of August, 2003. Pearlman Affidavit, ¶11.

25. Thus, the Debtor has had more than a month to respond to the Landlord's request to make a final decision respecting the assumption or rejection of the Lease. By the time of the hearing on this Motion, the Debtor will have had close to two months to consider the importance of the Premises to its overall operations and business plan. Limiting the Debtor's time to assume or reject to five additional days will therefore neither burden nor prejudice the Debtor. In contrast, any further extension of time is likely to jeopardize the Landlord's ability to complete the new lease transaction, thereby penalizing the Landlord for its attempt to resolve this issue without the need for formal proceedings. Such a result should not be countenanced by this Court.

Conclusion

26. An extension of the deadline to assume or reject the Lease beyond September 20, 2003 will have a significant adverse impact the Landlord. The Landlord will likely lose a prospective tenant, thereby incurring damage beyond the compensation permitted by the Bankruptcy Code. In contrast, extension of the deadline will give the Debtor an additional four

months to contemplate whether to assume or reject a Lease that it has apparently decided to reject unless the Landlord makes substantial modifications that are unacceptable to the Landlord. The Lease is not a primary asset of the Debtor, and provides no significant reversionary interest to the Landlord. A lease for space that the Debtor largely does not use is simply not necessary for its successful reorganization.

WHEREFORE, K.M. Complex, L.P. requests that this Court:

1. Fix September 20, 2003 as the date by which CTSnet, Inc. must assume or reject the Lease; and
2. Grant such additional relief as the Court deems appropriate.

K.M. COMPLEX, L.P.

By its attorneys,

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Dated: September 3, 2003

EXHIBIT A

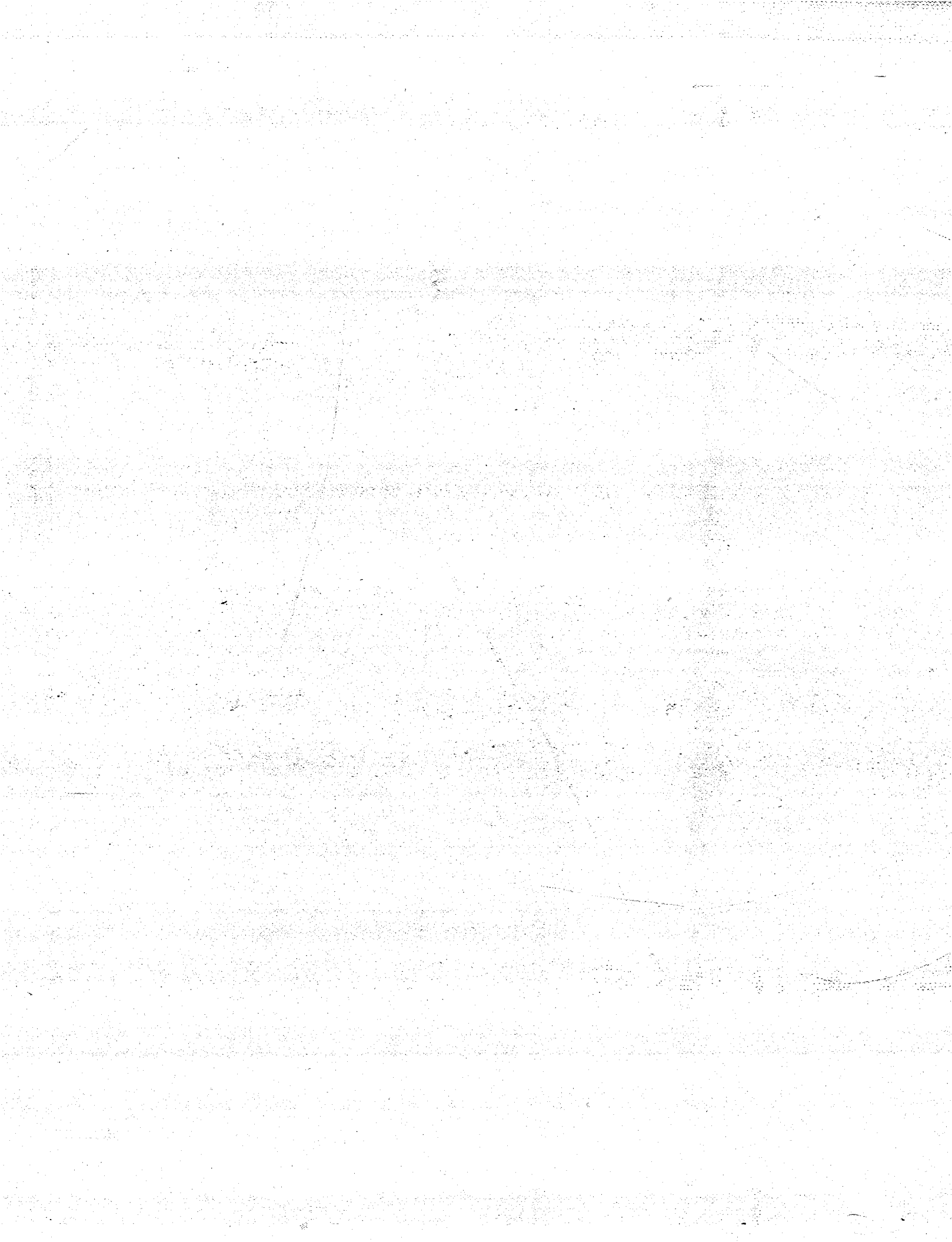
UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	X	
	:	
Allegiance Telecom, Inc., <u>et al.</u> ,	:	Chapter 11 Case No.
	:	03-13057 (RDD)
	:	
Debtors.	:	Jointly Administered
	X	

**ORDER PURSUANT TO SECTION 365(d)(4) OF THE
BANKRUPTCY CODE EXTENDING THE TIME WITHIN
WHICH THE DEBTORS MUST ASSUME OR REJECT
UNEXPIRED LEASES OF NONRESIDENTIAL REAL PROPERTY**

Upon the motion (the "Motion"), dated June 19, 2003 of Allegiance Telecom, Inc. and its direct and indirect subsidiaries, as debtors and debtors in possession (collectively the "Debtors") for an order pursuant to section 365(d)(4) of title 11 of the United States Code (the "Bankruptcy Code") for an extension of the period within which the Debtors may assume or reject unexpired leases of nonresidential real property, including those listed on Exhibit "A" annexed to the Motion (the "Unexpired Leases") through and including January 14, 2004, all as more fully set forth in the Motion; and it appearing that this Court has jurisdiction to consider and determine the Motion as core proceeding pursuant to 28 U.S.C. §§ 157 and 1334; and it appearing that the relief requested in the Motion is in the best interests of the Debtors' estates, their creditors, and other parties in interest; and it appearing that due and proper notice of this Motion has been given; and after due deliberation and sufficient cause appearing therefor; it is hereby

ORDERED that the Motion is granted; and it is



ORDERED that the time within which the Debtors may assume or reject the Unexpired Leases, pursuant to section 365(d)(4) of the Bankruptcy Code, is hereby extended to and including January 14, 2004; and it is further

ORDERED that the relief requested herein is without prejudice to the right of any lessor under the Unexpired Leases to move the Court to fix an earlier date by which the Debtors must assume or reject the Unexpired Leases in accordance with section 365(d)(4) of the Bankruptcy Code; and it is further

ORDERED that if a lessor requests the relief described in the preceding decretal paragraph, the Debtors shall maintain the burden of persuasion as to why the time within which the Debtors may assume or reject such lessors' Unexpired Lease(s) pursuant to section 365(d)(4) of the Bankruptcy Code shall continue through January 14, 2004; and it is further

ORDERED that the extension granted in this Order is without prejudice to the Debtors' right to seek further extension(s) of their time to assume or reject some or all of the Unexpired Leases.

Dated: New York, New York
July 2, 2003

/s/Robert D. Drain
UNITED STATES BANKRUPTCY JUDGE