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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

HEARING DATE: 2/25/04
AT: 10:00 A.M.

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In re: : Chapter 11
: Case No. 03-13057 (RDD)
: (Jointly Administered)
ALLEGIANCE TELECOM, INC., *et al.*, :
: Debtors. :
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DEBTORS' RESPONSE TO MOTION OF SBC TELECOMMUNICATIONS, INC. FOR AN ORDER COMPELLING THE IMMEDIATE PAYMENT OF AN ADMINISTRATIVE EXPENSE CLAIM PURSUANT TO 11 U.S.C. § 503(B)(1)(a)

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

Allegiance Telecom, Inc. and its direct and indirect subsidiaries, as debtors and debtors-in-possession (collectively, the "Debtors"), by their co-bankruptcy counsel, Togut, Segal & Segal LLP, as and for their Response to the Motion (the "Motion") of SBC Telecommunications, Inc. and certain affiliated operating telephone companies (collectively, "SBC") for an order compelling the immediate payment of an administrative expense claim, respectfully show this Court that:

PRELIMINARY STATEMENT

1. SBC seeks immediate payment of more than \$13.5 million¹ as an administrative expense priority claimant for charges allegedly incurred by the Debtors during the postpetition period. SBC maintains that it is entitled to immediate payment pursuant to (a) section 503(a) of the Bankruptcy Code, and (b) the Order dated May 15, 2003 deeming utilities adequately assured of future performance and establishing procedures for determining requests for additional adequate assurance (the "Utility Order"), which provides utility companies with an administrative expense claim for "valid" postpetition services.

2. The Debtors have determined that more than \$6 million of the amount sought by SBC under the Motion are for charges that were billed by SBC but not yet due and payable when the Motion was filed. In addition, prior to the filing of the Motion, on January 19, 2004, the Debtors paid SBC more than \$2.26 million for valid, undisputed charges. It is evident from the Motion that the amount sought by SBC under the Motion did not credit the Debtors for the January 19th payment. After the Motion was filed, the Debtors paid SBC, in the ordinary course of business, more than \$3.3 million on account of valid and undisputed charges. The Debtors continue to work closely with SBC in reconciling amounts due and to the extent the remaining open invoices are undisputed, the Debtors will pay SBC for such charges when payment is due.

3. The remaining amounts sought by SBC under the Motion – approximately \$5.4 million -- relate to charges that are disputed by the Debtors. Prior to SBC filing the Motion, the Debtors advised SBC's representatives of the disputed

¹ The exact amount sought by SBC is unclear. The Introductory paragraph to the Motion seeks payment of \$13,507,990.12 and paragraph 23 of the Motion seeks payment of \$13,774,160.86.

charges and the Debtors continue to cooperate with SBC in reconciling disputed charges. The disputed charges are for, among other things: (i) amounts that are not valid or otherwise due and owing under the SBC agreements, (ii) post-termination charges for circuits or services that were terminated by the Debtors, (iii) charges for services/ circuits that were not used by the Debtors, (iv) cancellation fees for terminated circuits, (v) redundant power fees, and (vi) double billings. SBC is not entitled to payment of these disputed amounts under the SBC agreements and/or under the Bankruptcy Code and, accordingly, the Motion should be denied.

OBJECTION

A. SBC Is Not Entitled To Payment For Disputed Charges Under The SBC Agreements And Section 503(b) of the Bankruptcy Code

4. It is axiomatic that a claimant is not entitled to an administrative expense priority under section 503(b) of the Bankruptcy Code unless such claimant can show that its charges are valid and its services/ goods provided an actual benefit to a debtor's estate. The Debtors dispute more than \$5.4 million of the amount sought by SBC. The disputed charges include post-termination charges for circuits and/or services that were terminated, cancellation charges for terminated circuits,² claims for redundant power fees, and charges that were double-billed. The disputed charges are not valid under the SBC agreements, did not provide any benefit to the Debtors' estates, and are not entitled to administrative expense priority under the Bankruptcy Code.

5. Claims asserted against a debtor's estate are not entitled to administrative priority unless they represent an "actual, necessary cost of preserving the

² In accordance with the SBC agreements, the Debtors have terminated numerous non-essential SBC contracts and services during the pre and postpetition periods. SBC has continued to charge the Debtors for the terminated services and has, in certain instances, sought cancellation fees for the terminated circuits.

estate.” See 11 U.S.C. § 503(b). “[A]dministrative expense priority should be narrowly construed to include only those creditors that perform services that are actual and necessary to preserve the bankrupt estate or that enable it to maintain its business.” In re CIS Corp., 142 B.R. 640, 642 (Bankr. S.D.N.Y. 1992) (“To require the entity to pay any expenses that are not necessary to its preservation or recovery would thus conflict with the goals of bankruptcy.”); see also In re R.H. Macy & Co., Inc., 170 B.R. 69, 76 (Bankr. S.D.N.Y. 1994); In re Drexel Burnham Lambert Group Inc., 134 B.R. 482, 488 (Bankr. S.D.N.Y. 1991). The burden of proving an entitlement to administrative expense treatment is on the claimant, and such relief should only be granted in those extraordinary circumstances when it is shown that the expenses were actual and necessary to preserve the estate. Drexel Burnham, 134 B.R. at 488.

6. A two-part test has been developed to determine whether claims should be entitled to administrative priority: (i) the claim must arise out of a post-petition transaction between a creditor and the debtor-in-possession and (ii) the consideration supporting the claimant’s right to payment was both supplied to, and beneficial to, the post-petition estate and operation of the post-petition business. See In re New York Trap Rock Corp., 137 B.R. 568, 572 (Bankr. S.D.N.Y. 1992). These standards are to be narrowly construed so as to preserve and maximize the estate for the benefit of all creditors. See Drexel Burnham, 134 B.R. at 488.

7. SBC has not demonstrated, nor can it demonstrate, that the Debtors’ estates obtained a benefit from any of the disputed charges. The disputed charges are for charges that are not valid under the SBC agreements or arise in connection with, or are related to, services/circuits that were terminated by the Debtors. The Debtors’ estates did not derive a benefit from such services/circuits.

8. Charges for services not used by the Debtors cannot give rise to an administrative expense claim against the Debtors. Potential, as opposed to actual, benefit to the Debtors' estates from the services/circuits provided by SBC is insufficient to confer administrative expense status on the charges. See In re Drexel Burnham Lambert, 134 B.R. at 488 ("The estate must have actually benefited, as opposed to potentially benefited . . . [Any actions taken independently by creditors] will not be compensable [as administrative expenses], notwithstanding any incidental benefit accruing to the bankruptcy estate").

9. In In re Enron, 279 B.R. 79 (Bankr. S.D.N.Y. 2002), the court held that the mere potential of benefit to the estate is insufficient to satisfy section 503(b)(1)(a)'s stringent requirement of actual benefit. According to the court, a claimant is not entitled to administrative expense priority for those services not actually used by the debtor during the post-petition period. Id. at 86. The Enron decision involved claims asserted by several counter-parties under Enron's natural gas transportation contracts. The court held that where there was no actual use of a pipeline post-petition, an administrative expense priority is not warranted. Id. at 88-90.

10. Any SBC charges arising from or related to the terminated circuits are not entitled to administrative expense priority. A substantial portion of the disputed charges, more than \$3 million, relate to services and circuits that were properly terminated by the Debtors. After termination, SBC continued to charge the Debtors for services connected to such circuits and/or seeks payment of cancellation fees. Clearly, these charges provide no benefit to the estates and SBC's request for immediate payment of these charges should be denied.

B. SBC Is Not Entitled To Payment Of Disputed Charges Under the Utilities Order

11. SBC seeks immediate payment of its postpetition invoices pursuant to the Utilities Order, which provides, in pertinent part:

ORDERED that, the Debtors shall pay on a timely basis, in accordance with prepetition practices, all *undisputed* invoices with respect to postpetition Utility Services rendered by such Utility Companies; and it is further

ORDERED that, under section 503(b)(1)(A) of the Bankruptcy Code, any *valid* unpaid utility charges that accrue postpetition constitute actual and necessary expenses of preserving the Debtors' estates, entitling the Utility Company to which those utility charges are owed to an administrative expense priority claim under section 507(a)(1) of the Bankruptcy Code (emphasis added).

12. The Utilities Order provides a utility service provider with an administrative expense claim for those charges that are "valid." Charges that are disputed by the Debtors are not entitled to payment or to administrative expense priority under the Utility Order. During these chapter 11 cases, the Debtors have timely paid SBC for valid and undisputed charges in the ordinary course of business. Since the filing of the Motion, the Debtors have paid SBC, in the ordinary course of business, more than \$3.3 million on account of undisputed charges. Charges that are disputed by the Debtors are not, nor can they be, considered "valid" charges under the Utility Order and, accordingly, SBC is not entitled to payment of such charges under the Utility Order.

CONCLUSION

13. The Debtors have paid, and will continue to pay, SBC on account of undisputed charges in the ordinary course of business and pursuant to ordinary business terms. To the extent SBC seeks payment for charges that are not yet due and for disputed charges, the Debtors respectfully request that the Motion be denied. The

Debtors are working with SBC and will continue to review billings in an effort to reconcile disputed charges. The Debtors reserve the right to supplement this Response with affidavits or legal memoranda prior to the hearing to consider the Motion.

DATED: New York, New York
February 20, 2004

ALLEGIANCE TELECOM, INC., et al.,
Debtors and Debtors-in-Possession,
By their Co-Bankruptcy Attorneys,
TOGUT, SEGAL & SEGAL LLP,
By:

/s/ Frank A. Oswald
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