

1 UNITED STATES BANKRUPTCY COURT
2 SOUTHERN DISTRICT OF NEW YORK

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4 In the Matter

5 of

Case No.
03-13057

6 ALLEGIANCE TELECOM, INC., et al.,
7 Debtors.

8 -----x

9 September 15, 2003

10 United States Custom House
11 One Bowling Green
New York, New York 10004

12 Application for Order to Employ CTA,
13 Houlihan Lokey and KPMG; Motion to Reject Certain
14 Unexpired Leases of Nonresidential Real Property;
15 Motion to Enter into Asset Management Agreement
with Source, Inc.; Motion to Extend Exclusive
16 Periods to File Chapter 11 Plan; Motion to Set date
which Debtor must Assume or Reject Unexpired Lease
of Nonresidential Real Property.

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18 B E F O R E:

19 HON. ROBERT D. DRAIN,

20 U.S. Bankruptcy Judge.
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1 ALLEGIANCE TELECOM, INC.

2 P R O C E E D I N G S :

3 THE COURT: Allegiance Telecom.

4 MR. HENES: Good morning, your
5 Honor.

6 THE COURT: Good morning.

7 MR. HENES: Your Honor, the first
8 two matters on the agenda today are the
9 committees', so at this point I'll turn it over to
10 Mr. Dublin.

11 MR. DUBLIN: Good morning, your
12 Honor Philip Dublin of Akin Gump on behalf of the
13 creditors' committee. The first two matters are
14 not objected to, and they were to hire Houlihan
15 Lokey as the operations consultant. As you recall
16 on October 29th, the court entered those orders
17 subject to the final hearing and notice to all the
18 parties seeking retention under 328. In connection
19 is an application interjection opposed on behalf of
20 the agent. We have not received any objection to
21 the final retention and request that the order be
22 approved on a final basis.

23 THE COURT: Okay. Is the G.E.
24 objection resolved on both of them?

25 MS. PLASKON: Not exactly, your

1 ALLEGIANCE TELECOM, INC.

2 Honor. We are fine with this going forward, but we
3 wanted to raise the point at some time whether CTA
4 needs to continue its engagement. At the last
5 hearing we talked about at this hearing setting a
6 date, or at least mapping out some time frame for a
7 hearing. I have not heard from the committee as to
8 whether they have mapped out that date, and we
9 would like to object because we think it's
10 duplicative to have both Houlihan Lokey and CTA
11 employed as financial advisors.

12 THE COURT: So it's a reservation as
13 well as an objection.

14 MS. PLASKON: Yes.

15 THE COURT: I think from the last
16 hearing, it seems CTA's work might be more
17 compressed and not as tied ultimately to valuation
18 issues that might come up at confirmation hearing,
19 for example. So I think the way I'm going to deal
20 with that is simply to note that the compensation
21 arrangement is approved under 328, but the
22 duration, which is not spelled out in the retention
23 agreement, is still subject to review under 330 and
24 331, so that if in fact it appears to third parties
25 that the committee should have terminated CTA

1 ALLEGIANCE TELECOM, INC.

2 sooner than it has, that it's an open issue for the
3 fee application.

4 MS. PLASKON: Thank you, your Honor.

5 MR. DUBLIN: Would you like me to
6 revise the order accordingly, your Honor?

7 THE COURT: I don't think you need
8 to, because I don't think that the duration of the
9 engagement is covered by the 328, but I'll leave it
10 up to G.E., if you people feel more comfortable.
11 Sometimes these things get forgotten and the
12 transcript may not be enough, so why don't you do
13 that just to make it clear that the retention under
14 328, approval of the compensation arrangements
15 under 328, does not extend to the issue of the
16 proper duration of CTA's retention, which is still
17 subject to Sections 330 and 331 of the Code.

18 MR. DUBLIN: If it's okay with the
19 court, your Honor, I'll revise the order
20 accordingly so that both Houlihan and CTA is
21 acknowledged.

22 THE COURT: I don't think there's a
23 problem with Houlihan. I think everyone has
24 acknowledged that Houlihan go forward with the
25 case.

1 ALLEGIANCE TELECOM, INC.

2 You can e-mail that to chambers.

3 MR. DUBLIN: Thank you, your Honor.

4 THE COURT: So I'll approve both
5 retention applications. And I guess that leaves
6 the debtors' motions then.

7 MR. HENES: Thank you, your Honor.
8 The debtors' first motion today is a motion to
9 reject a lease and abandon its personal property,
10 specifically, your Honor, the lease is between one
11 of the debtors' subsidiaries, Coast to Coast
12 Telecommunications, Inc. and First Parker Realty.
13 The premises covered by the lease is 123/125 North
14 Saginaw Road, in Pontiac, Michigan. The monthly
15 rent under the lease is 6,030 dollars, and the
16 lease is set to expire in 2005.

17 The debtors are no longer conducting
18 business there; they vacated those premises as of
19 today, I think. As of last week there were certain
20 properties that the debtors had used in the
21 operation of its business from those premises which
22 they no longer need. They are of inconsequential
23 value, and in fact, the Boston Market is selling
24 those pieces of property and there will be proceeds
25 generated from those as a result. The debtors have

1 ALLEGIANCE TELECOM, INC.
2 determined in their sound business judgment that
3 their rejection of the lease -- that the lease
4 should be rejected.

5 THE COURT: And the landlord has not
6 objected to the cause of rejection date?

7 MR. HENES: No.

8 (Pause in Proceedings.)

9 THE COURT: We're back on the record
10 in Allegiance. And again, Mr. Henes, if you can,
11 and everyone else who is speaking, if you can just
12 identify yourselves at the start of your remarks.

13 MR. HENES: Jonathan Henes, Kirkland
14 and Ellis on behalf of Allegiance. The fourth
15 matter for today, your Honor, is a motion to reject
16 certain executory contracts, unexpired personal
17 property leases and to abandoned certain personal
18 property related thereto. Specifically, your
19 Honor, the agreements we're seeking to reject, the
20 majority of them were interconnection agreements.
21 These are agreements that allow Allegiance to
22 connect to the local networks of the incumbent
23 local exchange carriers, and they cover leasing
24 space at the carriers' facilities, and circuits,
25 and other equipment. The debtors no longer need

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ALLEGIANCE TELECOM, INC.

the use of the facilities or the equipment at these central offices, and therefore want to reject these executory contracts because they are burdensome to the estate.

In addition, in the operation of their business at these central offices, there are certain personal property that the debtors would utilize. The debtors no longer need the personal property, the personal property being of inconsequential value and would cost more to market and sell than the proceeds that would be realized from such sale. And as a result, the debtors seek to reject the contracts and abandon the property.

There was one objection, your Honor, filed by one of the counter parties to one of the interconnection agreements which was made by Ameritech. We've worked that out, your Honor. And as part of that, we needed to make a representation on the record, which is that the debtors do not believe that any party other than the prepetition lenders have a lien on the personal property. The debtors are seeking to abandon that. The prepetition lenders do not object to the relief requested in the motion, and that the prepetition

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2 lenders will not be asserting any interest in the
3 personal property.

4 THE COURT: So in effect, they would
5 be abandon to Ameritech?

6 MR. HENES: That's correct, your
7 Honor, and we are seeking to abandon that.

8 THE COURT: All right. I've
9 reviewed the motion and will approve it as being in
10 the debtors' business judgement.

11 MR. HENES: Thank you, your Honor.

12 Your Honor, the next matter is the
13 debtors' motion to sell obsolete inventory and to
14 retain an agent to sell such inventory. In the
15 ordinary course of business, the debtors sell
16 certain telecommunication equipment systems and
17 parts to customers. The debtors have identified
18 certain surplus and obsolete equipment, which I'll
19 call the obsolete inventory. The debtors do not
20 have any need for this inventory but do incur costs
21 to store the inventory; and therefore, the debtors
22 have decided it's in the best interest to the
23 estate to sell this inventory. The best way to do
24 that to minimize value, the debtors have determined
25 is to engage basically a liquidator who has

1 ALLEGIANCE TELECOM, INC.
2 experience in selling this type of inventory. That
3 liquidator is Source, Inc. Source, Inc. has filed
4 an affidavit demonstrating its disinterestedness,
5 and based on that, your Honor, the debtors seek
6 your approval to have authority to sell the
7 obsolete inventory and retain Source, Inc. to do
8 that.

9 The prepetition lenders have filed a
10 limited objection to this motion, your Honor.
11 Their objection basically states that they need to
12 have their rights protected or adequate protection.
13 And so the way they see that is with the liens that
14 they have attaching to any proceeds of that sale,
15 and they would like the debtors' to submit the
16 proceeds to them.

17 The debtors believe they are
18 adequately protected by having their liens attached
19 to the proceeds and don't see the need or know what
20 authority we would have to pay over the proceeds,
21 but I will allow it.

22 THE COURT: Let me ask you, where
23 are the sale proceeds going to be deposited?

24 MR. HENES: They would be deposited
25 into the -- I don't know the exact bank accounts,

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2 but we will make sure it's one of the bank accounts
3 that cash collateral is covered under.

4 THE COURT: Okay. How are you going
5 to monitor Source, Inc.? I noticed that there was
6 like a two step sort of arrangement. Do you have
7 someone at Allegiance that's interacting with them
8 to make sure they don't move too quickly to step
9 two.

10 MR. HENES: We do, and I will make
11 sure that doesn't happen, your Honor.

12 THE COURT: Let me hear from G.E.
13 and anyone else who wants to comment on the motion.

14 MS. PLASKON: Your Honor, Leslie
15 Plaskon with Paul Hastings for the prepetition
16 lenders.

17 We think it's fairly straight
18 forward and typical that in a 363 sale context if
19 the lender has liens on the assets, the proceeds
20 ultimately are remitted to the lender. We're not
21 sure why there is a dispute here. The debtors
22 agreed in the cash collateral stipulation that we
23 have a lien on all of the assets the of the estate.
24 There's no dispute here that these particular
25 assets being sold are subject to our liens. We are

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2 not sure why there is an issue and the need for an
3 escrow and can easily be remitted to the lenders.

4 MR. DUBLIN: Phil Dublin for the
5 committee. Your Honor, the committee is still
6 undertaking its analysis of the bank groups' liens.
7 We currently have until October 13th to complete
8 that analyses and pursue any actions with respect
9 to the liens or other actions to the bank group.
10 We also agree with the debtors that the banks are
11 adequately protected to the extent the funds are
12 deposited in an account that belongs to a bank
13 group lender. And absent the bank group showing
14 that they are not adequately protected and the
15 liens attaching to the proceeds, we don't see the
16 need for the relief they seek today.

17 THE COURT: Is the lien on these
18 particular assets still an open issue?

19 MR. DUBLIN: I don't have personal
20 knowledge, your Honor. I have to check with the
21 people in our corporate group that are doing that
22 analysis, but I can report back after I find that
23 out.

24 MS. PLASKON: Your Honor, we would
25 suggest as a compromise, since the committee does

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2 have until the 13th of October to complete its
3 investigation, that the proceeds be escrowed until
4 that date. And then if at that point the committee
5 has a specific concern regarding our lien with
6 respect to this inventory, then we continue to keep
7 the proceeds in escrow. But assuming that they
8 don't, and we don't believe that they do have any
9 issue with respect to this collateral, the proceeds
10 would then be remitted to the lenders at that
11 point.

12 MR. DUBLIN: Your Honor, I still
13 believe the banks need to show how they are not
14 adequately protected in the cash in the account.
15 However, I'm happy to check on that analysis, and
16 maybe we can reach some type of middle ground or
17 see where we are in a month on this case in
18 general. But until I that time, I think it's
19 premature to make a complete statement.

20 THE COURT: Is there any issue as to
21 whether the banks are oversecured or not?

22 MR. DUBLIN: We believe the banks
23 are over secured, your Honor.

24 THE COURT: Is there an issue as to
25 whether they are or not?

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2 MR. DUBLIN: I think that would
3 be -- the debtors may take a different position and
4 the banks may take a different position than we do.

5 MR. HENES: There is an open issue
6 on that.

7 THE COURT: Okay. At this time I'm
8 going to deny the objection based on two factors;
9 one is the ongoing analysis by the creditors'
10 committee. I appreciate the suggestion by G.E.
11 that the picture may change on October 13th or
12 whenever it is that the secured creditors and the
13 committee agree to be the ultimate cutoff date on
14 that analysis, but I think there still would be
15 issues at that point as to the proper consequences
16 of the release of the funds that relate to whether
17 the banks are oversecured or not, and the issue of
18 postpetition interest. So I think that it is clear
19 that the banks are adequately protected, given the
20 debtors' cash position, so that as long as the
21 liens attach to the proceeds, and as Mr. Henes
22 said, the proceeds are deposited in one of the
23 accounts covered by the cash collateral order, I
24 think the banks are protected.

25 I don't recall whether the program

1 ALLEGIANCE TELECOM, INC.
2 laid out with Source provides for reports to G.E.
3 I have a vague memory that there is a monthly
4 report. But if there isn't, there should be some
5 periodic reporting on a monthly or bi-weekly basis;
6 and so you should put that in the order if it isn't
7 already, of the collateral sales.

8 MR. HENES: We will do that, your
9 Honor.

10 MR. DUBLIN: Your Honor, Phil Dublin
11 for the committee. If we can just get a copy of
12 those reports as well?

13 THE COURT: That's fine.

14 So obviously the bank has leave to
15 seek stay relief. This is just a ruling based on
16 today's facts.

17 MR. HENES: Thank you, your Honor.
18 Your Honor, the final matter is the
19 motion of K.M. Complex for an order to pursuant to
20 Section 365(d)4 of the Bankruptcy Code to set
21 September 20th as time to reject certain leases.
22 And I'll turn that over.

23 MR. GOLDBERG: Good morning, your
24 Honor. Michael Goldberg of Sherin and Lodgen in
25 Boston, Massachusetts here on behalf of K.M.

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2 Complex, L.P. If I can just pull my papers out for
3 a moment I'll be ready to address the court.

4 We are here, as debtors' counsel
5 states on our motion, for an order compelling the
6 debtors to assume or reject a lease between K.M.
7 Complex and the debtor covering a teleco facility
8 space in San Diego, California. This space is
9 known as -- the building in which the space is
10 located is known as the Kearney Massa Complex. The
11 debtors rent approximately 28,491 square feet in
12 that complex.

13 The hearing today is really the
14 culmination of an attempt that's taken several
15 months to get the debtors' to focus on their future
16 intentions with respect to this space and give the
17 landlord some clarity. We have filed with our
18 motion, an affidavit of Todd Pearlman, who is with
19 Yale Properties, USA, the parent company and
20 property manager for the Kearney Massa Complex, and
21 Mr. Pearlman is here today and is available for
22 cross-examination and also to give some additional
23 testimony.

24 But according to Mr. Pearlman's
25 affidavit, we had been in regular touch with the

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2 debtor since they filed this bankruptcy case, and
3 from early on in this case, the debtors' former
4 vice president, Mr. Kenneth Close, who informed us
5 of the debtors' likely intention to reject this
6 lease in the absence of a substantial reduction in
7 the amount of space at the premises together with a
8 reduction of the rental rate.

9 With that reduction, my client
10 simply was not and is not willing to make that
11 agreement with the debtor. With that information
12 in hand, my client tested the market to see, if
13 this lease were to be rejected, what was to be the
14 likely result, and was fortunate enough to receive
15 an offer to rent about 13 thousand square feet of
16 the space. And in a moment, with your Honor's
17 indulgence, I'll explain to you how the space is
18 laid out and how these different square footages
19 interact with each other.

20 This offer came in in July of 2003,
21 and we notified the management as well as debtors'
22 counsel of this development; debtors' management
23 late in July, and debtors' counsel in early August.
24 And we did not file a motion at that time because
25 frankly what we asked the debtor to do is to

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2 consider its intentions with respect to the space
3 and allow us to move forward with an alternative
4 leasing opportunity which we believe would not only
5 benefit the landlord, us, but provide a significant
6 benefit to the creditors of this estate by
7 mitigating our potential rejection claim.

8 We were told we would get an answer
9 by the end of August. We didn't get an answer.
10 Multiple phone calls later, we finally just decided
11 to file our motion. I'm sure the debtor is going
12 to make a great moment of the fact that the motion
13 was filed September 3rd or 4th and sought a hearing
14 on September 15th and a deadline on September 20th.
15 The fact of the matter, your Honor, is that we
16 didn't just raise this issue on September 3rd or
17 4th, we've raised this issue now for quite some
18 time. We've attempted to work this out with the
19 debtor and we simply don't have any more time.

20 Our alternative tenant who we want
21 to put in, needs to move in by December 1st. And
22 they originally told us that we would have until
23 October 1st to tell them whether or not we could
24 make the space available. We have since been told
25 by their leasing broker, who happens to have been

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2 in touch with management personnel of the debtor,
3 that in fact the debtor now isn't likely to reject
4 the lease; and so our prospective tenant says that
5 if they don't hear from us today, they are just
6 going to sign a lease with a different piece of
7 property.

8 So unfortunately, your Honor, there
9 is no tomorrow. If we don't have a decision by the
10 debtor to assume or reject the lease by the end of
11 this week, if they are not compelled to do so by
12 the end of the day, we will lose a lease which will
13 guarantee a significant amount of rent for a
14 significant portion of the space, and we will also
15 lose the opportunity to mitigate the damage claim
16 that we have in this case.

17 I want to point out to this court
18 two things. One is that the burden of proof is not
19 on the movant in this situation, it is on the
20 debtor. This court entered an order, when it
21 extended the deadline to assume or reject leases to
22 January 14th, 2004 in which it made clear that if
23 any landlord sought an earlier time for the debtor
24 to assume or reject a lease, that the burden of
25 proof would be on the debtor to show cause as to

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2 the validity of an extension. In other words, the
3 debtor would be treated as having made this request
4 today, not the movant. So I believe in fact it is
5 the debtors' burden today to show by a
6 preponderance of the evidence, that in fact there
7 is good and sufficient cause for an extension of
8 time under Section 365(d)(4).

9 Point number two is that the
10 applicable law in this district, as well as around
11 the country, I think it stems from a case called in
12 re Webtech Corporation. And under Webtech
13 Corporation, this court is required to engage in a
14 balancing analysis; the court is required to
15 balance the debtors' need for time to evaluate the
16 space and the importance of the space at issue
17 against the potential harm to the landlord that is
18 not recoverable by the Bankruptcy Code. And we
19 submit to this court that when it considers the
20 amount of time that the debtor has already had to
21 reach a decision in this case, against the damage
22 to the landlord of having to forego this leasing
23 opportunity which runs ten years from the day --
24 from December 1st, 2003, I think this court will
25 conclude it has no other choice but to grant the

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2 motion.

3 Just, if I can indulge the court's
4 patients for a few more moments. I wanted to run
5 through a few basic facts to make things clear.
6 This is a space, as I mentioned before, where the
7 debtor leases 28,491 square feet. There is some
8 difference in the papers on the issue of how much
9 space the debtor currently uses. There is a
10 substantial portion of space, which is office
11 space, which the debtor doesn't use, and I think we
12 can stipulate to the fact the debtor doesn't use
13 the office space at all.

14 There is a portion of the space
15 which houses telecommunications equipment, and I
16 think that we do have a difference of opinion as to
17 the intensity of the debtors' use of that space.
18 The current lease expires on October 31st, 2005.
19 Our new lease is for 13,000 square feet, which
20 roughly comprises the equipment storage portion of
21 the facility, the telecommunication portion of the
22 facility.

23 THE COURT: So it overlaps with the
24 portion of the facility that the debtor is using?

25 MR. GOLDBERG: That is correct. And

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2 our new tenant, which is a solid credit tenant, is
3 quite clear that that's the part of the space they
4 need. It is, as I mentioned before, the lease is
5 for ten years, which means that we wouldn't just
6 mitigate -- the rent, by the way, is just for
7 slightly less than the rent rate that the debtor is
8 paying. It runs through the current term of the
9 debtor's lease, including an additional eight years
10 beyond that. So in addition to the mitigation of
11 13,000 square feet worth of rent at virtually the
12 same rent under the current lease, there's an
13 opportunity cost of eight additional years worth of
14 rent that is involved in this new lease.

15 Mr. Pearlman's affidavit states, and
16 certainly he can make clear today if the court
17 would like, that the telecommunications market, in
18 terms of the real estate side of the market, is
19 very soft. These opportunities are very difficult
20 to come by. I'm sure the very fact that we are
21 here today in a large telecommunications bankruptcy
22 is at least a testament of the difficulties for the
23 landlords in the telecommunications real estate
24 market. So our the argument is simple, your Honor,
25 under the Webtech balancing test, we believe that

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2 the potential harm to the landlord outweighs any
3 other factor that this court must apply.

4 The debtor, of course, makes the
5 argument that this is a valuable assets in its
6 telecommunications network, without which it cannot
7 function. Well, your Honor, I assume we will hear
8 testimony today that will support some of the
9 allegations made in the debtors' objection. There
10 is certainly broad allegations, and they need to be
11 tested with additional questioning and hopefully
12 some additional financial information as well. But
13 I would only say this: We have been asking the
14 debtors to focus on this issue since the end of
15 July.

16 The first time that we believe
17 anyone from debtors' management even looked at the
18 space in an attempt to determine whether there was
19 a way to reconfigure it or to move to another
20 location in the Kearney Massa Complex, was this
21 past Thursday. It's already too late, frankly, for
22 us to try to resolve this issue. But what we heard
23 back from the debtor at the end of the day was,
24 "gee, we're really sorry, we need another 30 days
25 to even figure out whether this is economically

1 ALLEGIANCE TELECOM, INC.

2 feasible." Well, our response to that is what have
3 the debtors been doing for the last 30 days, and
4 why wasn't this important enough for us to be able
5 to resolve this issue without filing a motion. So
6 the debtor may need more time, according to its own
7 argument, but frankly they had that time and wasted
8 it and shouldn't benefit from the fact that it
9 didn't timely and appropriately respond to our
10 initial request.

11 The last point I will make, your
12 Honor, is that in addition to the burden to the
13 landlord, and it is an extensive burden to the
14 landlord, again we are talking about eight years of
15 lost rent that we will never recover given the
16 502(b)(6) cap under the Bankruptcy Code, there is
17 the loss of mitigation to the debtors' creditors
18 that has to be factored in here. So when you
19 factor in all of those elements, and we believe
20 this court will grant the motion and will require
21 the debtor to decide whether to assume or reject
22 the lease by the end of the week.

23 Just as a procedural point, as I
24 mentioned before, I have Mr. Pearlman here, and I
25 would like to ask him a couple of questions in

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PEARLMAN - DIRECT

addition to his affidavit. I assume we can stipulate to the existence of the lease and amendments and the guarantees; those documents are submitted with his affidavit. He is here to answer any questions the debtor may have. And I assume the debtor may have its own witnesses to support the allegations made in their objection.

THE COURT: So are you going to put him on the stand now for limited direct --

MR. GOLDBERG: Yes.

THE COURT: -- to supplement his affidavit?

MR. GOLDBERG: Yes.

THE COURT: All right. Mr. Pearlman, if you could take seat up there.

MR. PEARLMAN: All right.

T O D D P E A R L M A N, called as a witness, having been first duly sworn by the Notary Public, Denise Nowak, was examined and testified as follows:

EXAMINATION BY MR. GOLDBERG:

Q. Would you state your name for the record, Mr. Pearlman?

A. My name is Todd Pearlman.

1 PEARLMAN - CROSS

2 Q. And your position?

3 A. I am the director of leasing for
4 Yale Properties USA.

5 Q. How long have you been with Yale
6 Properties USA?

7 A. Six years.

8 Q. Can you tell us the difference
9 between Yale Properties and K.M. Complex, L.P.
10 properties?

11 A. Yale Properties USA, Inc. is the
12 management arm and the owner of Yale Properties
13 USA, Inc. is the general partner of K.M. Complex,
14 L.P.

15 Q. You mentioned that you were at Yale
16 Properties six years. What other related
17 experience did you have prior to Yale Properties?

18 A. I've been in the Southern California
19 real estate market since 1992.

20 Q. And at Yale Properties, you
21 mentioned that your position was director of
22 leasing. Can you tell us, have you been involved
23 in negotiating telecommunications leases or leases
24 for telecommunications facilities?

25 A. Yes.

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2 Q. And can you tell us approximately
3 how many of those leases have you negotiated over
4 your six years at Yale Properties?

5 A. Approximately 50 maybe, somewhere in
6 the neighborhood of 50.

7 Q. And approximately how much of your
8 time at its peak would have been spent on
9 negotiating telecommunications leases or leases for
10 telecommunications facilities?

11 A. 50 percent.

12 Q. In the debtors' objection, they
13 mention that the debtor is now utilizing 40 percent
14 of the space that they lease at the Kearney Massa
15 Complex. Can you tell us a little bit about what
16 you understand to be the state of the debtors'
17 space at the Kearney Massa Complex?

18 A. When you tour their space, it is
19 clear that they have infrastructure in place,
20 infrastructure working. Their equipment is on --
21 its very difficult to determine what percentage of
22 the space is being utilized. But from a leasing
23 perspective walking in the space, my guess would be
24 somewhere in the neighborhood of 15 percent of the
25 space.

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2 Q. Most of the space is used for what?
3 What kind of structures are in the space?

4 A. Inside the space is comprised of
5 cabinets to support or host clients of theirs. The
6 particular division of Allegiance Telecom that is
7 in our property is called hosting.com, and they
8 have racks, servers held within racks, held within
9 cages, comprising maybe 10 percent of the space,
10 along with backup for those cages, which is battery
11 backup, and uninterrupted power source, what's
12 called a UPS system, and all the infrastructure
13 that's involved to bring those connections out into
14 the world and connect them wherever those lines are
15 going, backup generation as well.

16 Q. Looking at these cabinets and racks,
17 is there any way to tell whether they are
18 completely full of operating equipment?

19 A. There is, from a layman's
20 perspective and my perspective, it's very easy to
21 see if lights are on or off and whether there's
22 equipment inside these cabinets. Most of the space
23 is rack ready, in other words there's support on
24 the ceiling to put in additional cabinets that are
25 not there at this time. And of the cabinets that

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2 are there at this time, no, it is very difficult to
3 determine how much they are used. I do not know.

4 Q. And as you look at the room that
5 contains these racks, is it a quarter empty? Is it
6 a third empty? Can you give us a sense of how full
7 of racks it is?

8 A. I'm guessing it's approximately 15
9 percent full. I would say more than roughly 80
10 percent is empty.

11 Q. Now another thing that the debtor
12 states in their objection is that they could lose
13 up to 30 percent of the revenues generated at this
14 location if they are required to move. Do you
15 believe that's accurate?

16 A. I believe that if their move wasn't
17 handled correctly, yes, absolutely. But if they
18 were to source another location and seamlessly
19 migrate into that location, no, I don't believe so.

20 Q. I know you read the debtors'
21 objection, and if you need to be refreshed, I'm
22 happy to do it, but the debtor talks about the
23 process of moving and suggests that it would take
24 four to five months to move, to test equipment. In
25 your view, is that an adequate amount of time to

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2 perform a seamless move?

3 A. Once a location is identified, and
4 if the resources were made available, I would -- my
5 best guess would be that they could do it a lot
6 quicker.

7 Q. Without customer loss?

8 A. Without customer loss.

9 Q. The market for telecommunications
10 facilities in Southern California, can you tell us
11 about it, please?

12 A. The market for telecommunications in
13 Southern California is the same as it is anywhere
14 in the United States. We have property Boston, San
15 Francisco and San Diego, and the market has been
16 decimated, as the clear indication of the amount of
17 bankruptcy proceedings in our industry. The teleco
18 market for our industry has all but vanished for
19 all of the competitive local exchange carriers that
20 were not as well funded as need be or have had --
21 went through too much cost to quick.

22 Q. So, is it fair to say that if you
23 don't take advantage of this leasing opportunity,
24 another one would be very difficult to come by?

25 A. Yes. That's the core point of

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2 today. We have a company of accredited home
3 lenders that is very interested in taking our
4 space. They have signed a letter of intent. They
5 are waiting to sign a lease with another landlord
6 down the street if they don't get our property; and
7 I'm very concerned if they were to go away, it may
8 be many, many years, if ever, that we find a teleco
9 carrier that wants to utilize what's in this space
10 and move in.

11 MR. GOLDBERG: I have no further
12 questions, your Honor.

13 THE COURT: Do you have any cross?

14 MR. HENES: I have no questions,
15 your Honor.

16 THE COURT: Let me ask you, what's
17 the basis of your knowledge when you say that they
18 are waiting to sign a lease with another landlord
19 down the street?

20 A. We had a conference call with their
21 director of real estate on Friday. We told him we
22 had a hearing today. And he said that as a backup,
23 even though they signed a letter of intent with us,
24 they were very concerned.

25 Over the last 30 days they had been

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2 placing their own calls. Their broker, Alex Hayden
3 for CV Commercial, has been placing his own calls
4 into Allegiance management to try to determine if
5 what I was telling him, what we as a company were
6 telling him was correct. And while we kept saying,
7 "guys, we are going to get you the space," doing
8 our best selling, he kept hearing from Allegiance
9 itself that there's no way, "we don't think we can
10 reject that space. We don't know what's going on.
11 We haven't yet determined. We'll get back to you,"
12 so they felt very insecure. And so on Friday they
13 said we will give you guys through today. You let
14 us know. And if you don't have an answer today,
15 then we are going to go ahead and sign. At that's
16 the reason why I flew out here, why we are here.

17 THE COURT: Okay. Anyone else have
18 any questions?

19 All right, Mr. Pearlman, you can
20 step down.

21 (Whereupon, the witness was excused)

22 MR. GOLDBERG: I have no further
23 witnesses, your Honor.

24 THE COURT: You referenced the
25 guarantees that are mentioned in the lease. Are

1 ALLEGIANCE TELECOM, INC.

2 the guarantors all the debtor entities or are there
3 any other third party guarantors?

4 MR. GOLDBERG: There is one
5 guarantee that I'm aware of, your Honor, that I'm
6 aware of. The tenant here is actually an entity
7 called CTS Net, Inc., which I understand is one of
8 the debtors' affiliates. The guarantor is
9 Allegiance Telecom, Inc.

10 THE COURT: Have you done a --
11 assuming that the lease with the perspective tenant
12 were ended into, which is for you say roughly
13 13,000 square feet at a rate somewhat less than
14 what the debtor is paying. Is it paying per square
15 foot or paying for the whole premises?

16 MR. GOLDBERG: Paying for per square
17 foot.

18 THE COURT: So have you done a
19 damages calculation, assuming the debtor rejected
20 the lease as of today, whether that new deal would
21 in fact mitigate damages, or would there still be a
22 claim against the debtors' estate?

23 MR. GOLDBERG: I assume, your Honor,
24 you are asking whether, comparing the balance of
25 the claim to the cap, the 502(b)(6) cap?

1 ALLEGIANCE TELECOM, INC.

2 THE COURT: Yes.

3 MR. GOLDBERG: I did not, but I
4 could do one quickly.

5 THE COURT: Because it strikes me
6 that there would still be a substantial breach
7 claim even if you relet the premises. Maybe I need
8 to hear more about what the new lease rent is, but
9 it sound likes there would still be a substantial
10 breach claim against Allegiance.

11 MR. GOLDBERG: There would be about
12 15,000 square feet or so not covered by this new
13 lease that would run for two years at \$1.50,
14 roughly, a square foot, although there are bumps in
15 the rent rate. Of course that gets capped by
16 502(b)(6), so I think what we are looking at is one
17 years worth of rent for the office space. We could
18 figure it out and report back.

19 THE COURT: One of your arguments is
20 that this is good for the estate as well because
21 you eliminate a breach claim or mitigate a breach
22 claim, and it just wasn't clear to me whether that
23 actually would be the case, given that they are
24 only renting roughly 45, 46 percent. They would be
25 renting only 45 or 46 percent of the space at a

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somewhat lesser rate per square foot.

MR. GOLDBERG: Well, as I said, your Honor, at a recess we can gather the numbers and get back on that.

THE COURT: Okay, that's fine.

Mr. Henes?

MR. HENES: Thank you, your Honor. I'll be calling a witness.

THE COURT: Okay.

MR. HENES: Mark Tresnowski.

M A R K T R E S N O W S K I, called as a witness, having been first duly sworn by the Notary Public, Denise Nowak, was examined and testified as follows:

EXAMINATION BY MR. HENES:

Q. Mr. Tresnowski, could you state your name and position with the company for the record, please?

A. My name is Mark Tresnowski. I'm executive vice president and general counsel of Allegiance Telecom.

Q. Are you familiar with the lease at the Kearney Massa Complex?

A. Yes. I am, among others things.

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2 I've been involved with all the companies' mergers
3 and acquisitions, and CTS is actually a company
4 that we bought. And I've been out to the site to
5 do due diligence so I'm familiar with it.

6 Q. Are you familiar with the business
7 that's run on the premises?

8 A. Yes.

9 Q. Could you please describe that
10 business?

11 A. It's really a combination of two
12 businesses; one is hosting websites for customers
13 of Allegiance, so we host the website and then the
14 people access that website by coming over the
15 internet into those premises and can do the
16 contents of the websites there, and those take
17 several forms. We can have shared hosting where
18 several clients share one server. We can have
19 dedicated hosting where we put a server in that's
20 dedicated to that particular customer, or we can do
21 what they call colocation, which we do at this
22 facility as well, where it's basically a hands off
23 service; the customer comes in and maintains their
24 own equipment' it's probably the highest level of
25 web hosting so to speak.

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2 The other thing we operate out of
3 the facility is we are an internet service
4 provider, which means that we help customers access
5 the internet, just like an AOL or any other kind of
6 big ISP.

7 Q. Can you describe a bit what the
8 premises looks like in terms of the servers being
9 in these cages that was discussed earlier?

10 A. It's a very high quality facility.
11 It was actually just renovated when we bought the
12 company. What they do, because you've got a
13 tremendous amount of heat generated from these
14 servers, is that you have raised floors and
15 controlled climate. So it's a very significant
16 investment into the facility. And that's obviously
17 important, because you need to provide that kind of
18 security for these customers, but it's also
19 important from a customer's perspective. One of
20 the things you are selling is the site; when they
21 walk in there they can see the level of
22 infrastructures that you put in and the level of
23 security and fire systems and things like that.

24 Q. Do you know how much revenue per
25 month roughly is generated by the business?

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2 A. I think it's roughly a million
3 dollars a month.

4 Q. Just to step back, are you aware of
5 the process that the debtors are doing to analyze
6 their leases and contracts?

7 A. Yes, I am.

8 Q. Can you please describe what the
9 company is doing?

10 A. Well, it's -- I guess I would say
11 it's a tiered approach. We have all different
12 types of facilities. We have a sales office, for
13 example, that doesn't have a lot of improvements.
14 And it's simply a question of do you utilize the
15 space, is this space that you still desire, is the
16 rate still at a market rate. And then it gets more
17 complicated as you get into technical space where
18 we are actually serving customers out of that
19 space.

20 It gets very complicated when you
21 are talking about a facility like this where we
22 host web sites, because one of the things that's
23 fundamental to our business and businesses like
24 ours is that we're a network company. And a
25 hosting center is part of a network; you can't

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2 analyze it in isolation and say is this a good
3 lease, is this a good facility. What you have is,
4 and we currently have three hosting centers in the
5 country, and I think this is our second largest.
6 Our largest is in Boston. But when you analyze
7 those centers, you need to also analyze the fact
8 that we operate our own internet backbone. And we
9 are one of the top ten internet service providers
10 in terms of traffic, a big difference between us
11 and the people at the very top of that scale like
12 UU Net. But nonetheless, it's -- a strategic issue
13 for us is whether we want to continue to own and
14 operate our own backbone or whether, given the
15 changing economics in telecom, whether you want to,
16 in essence, lease a backbone, which is what they
17 call buying transit. And just to use an example,
18 we can buy transit from UU Net and abandon our
19 backbone, and that's a very complicated analyses
20 that you go through, but in order to decide whether
21 you want to keep a hosting facility, you need to
22 also look at that decision, because if you keep
23 your own backbone and you don't keep your hosting
24 site, you are going to eliminate a lot of the
25 traffic that's going to keep the backbone economics

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2 justifiable.

3 So what we are currently looking at
4 is the following issues that impact this particular
5 decision. One is do we or do we not want to own
6 and operate our own backbone. And the I guess
7 related issue and what we are working on is can we
8 sell the hosting business. And if we sell it, do
9 we sell just the shared hosting, which is kind of a
10 different market segment, or do you sell also the
11 dedicated and colocation segments. And we are
12 actually out there talking to the many different
13 parties about that. They have made offers to buy
14 the shared hosting division. They have asked us to
15 put the dedicated hosting division on the table.

16 So we are getting indications of
17 value. And one of the things we would look at is
18 would a buyer take over the lease and, you know,
19 eliminate damages to the estate. And that's
20 obviously one of the values that a buyer could give
21 to us. So those are some of the many issues that
22 go into a decision like this.

23 Q. So does this decision on this lease,
24 does it have an impact on the debtors' total
25 restructuring?

1 TRESNOWSKI - DIRECT

2 A. I think it definitely does, because
3 it can, again, when you are asking that question
4 about a network business, and, you know, decisions
5 that may not seem big in isolation that will affect
6 other decisions here. You can say this is just a
7 hosting center in San Diego, what do you want to do
8 with it? The answer is, the yes or no on that may
9 give you a yes or no on your backbone, may give you
10 a yes or no on your network expenses for leasing
11 transit. And the decision is not made that way,
12 it's made on the top down, and at the end of that
13 process does it kick out a yes or no on the site.

14 Q. If the debtors were forced to make a
15 determination and the determination on the lease
16 was to reject it, would it take a significant
17 amount of time to move this location?

18 A. It would. We've done that in the
19 past. The problem is you don't move it down the
20 street so to speak. You utilize any other space
21 you might have.

22 You know, one of the things we would
23 consider here is moving those customers to Boston.
24 We've moved a hosting center prior to the
25 bankruptcy from Chicago to Boston, and with mixed

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2 results, because what you find out when you do that
3 is that some customers are using you as a hosting
4 center because you are in their city and they can
5 go to your data room and that's important to them;
6 other customers don't care. You don't really know
7 until you try to move them and then you find out
8 how much of that revenue you've lost.

9 Q. Have the debtors done an analysis to
10 determine how much revenue they think they might
11 lose as a result?

12 A. Yes. I think we estimate it at
13 about 30 percent; that's a bit of a stab in the
14 dark because you don't know until you do it. But
15 based on the experience we've had before, we would
16 estimate it at about 30 percent.

17 Q. And the final question, Mr.
18 Tresnowski, is are the debtors current on their
19 rent with respect to this lease?

20 A. I believe so, yes.

21 Q. Thank you.

22 THE COURT: Do you want to
23 cross-examination him?

24 MR. GOLDBERG: I do. Thank you,
25 your Honor.

1 TRESNOWSKI - CROSS

2 CROSS EXAMINATION BY MR. GOLDBERG:

3 Q. Mr. Tresnowski, how long have you
4 been with Allegiance Telecom?

5 A. I have been affiliated with the
6 company since its inception. I was outside counsel
7 to the company, securities law and M and A counsel
8 to the company since its inception in 1997, until
9 January of 1999 at which point I joined full time.

10 Q. So your background is as a private
11 practitioner prior to joining Allegiance Telecom?

12 A. That's right.

13 Q. And your areas of specialty were
14 securities law and M and A work?

15 A. They were, although I did a broad
16 range of what I would call business law, and I've
17 kind of branched out in my specialty since then.
18 And after about a year at Allegiance, I took not
19 only the legal department, but the regulatory
20 department, human resources and the real estate
21 function and managed those.

22 Q. Have you ever overseen the build out
23 of a telecommunications facility?

24 A. No, I have not.

25 Q. Have you ever been a comptroller or

1 TRESNOWSKI - CROSS

2 chief financial officer of Allegiance or any other
3 company?

4 A. I've been offered positions like
5 that, but I've never taken them, no.

6 Q. You mentioned before your estimate
7 of a million dollars per month in revenue. Where
8 does this estimate come from?

9 A. I talked to our senior vice
10 president of finance who now is in charge of real
11 estate function, Clay Meyers.

12 Q. Is he here today, by any chance?

13 A. No, he is not.

14 Q. Does the company prepare reports for
15 each of its locations, profit and loss reports from
16 each of its locations?

17 A. No, not on a location by location
18 basis.

19 Q. So, you don't have today any written
20 information or other data that would support the
21 estimate of a million dollars in gross revenue; is
22 that right?

23 A. I don't have any data with me today,
24 no.

25 Q. Do your companies' financial

1 TRESNOWSKI - CROSS

2 statements -- I assume they are regularly audited;
3 is that right?

4 A. That is correct.

5 Q. Did those audit statements show
6 profit and loss by location?

7 A. No, they do not.

8 Q. Of course the million dollar figure
9 is a revenue figure, not a profit and loss figure.
10 Are you aware of the expenses that relate to the
11 million dollars worth of revenue a month?

12 A. No, I don't know the specific number
13 of expenses per month.

14 Q. So as far as you know, you could be
15 losing money at the San Diego location; is that
16 right?

17 A. Well, I suppose that's possible, but
18 that's not the way we would analyze it. Because
19 again, the existence of the San Diego location and
20 the hosting center affects the economics of the
21 backbone and the rest of the business as well.

22 Q. I understand the backbone analysis,
23 in fact I thought it was very helpful. But I point
24 out to you the fact that the debtor in its
25 objection, said that at this location it was

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2 generating a million dollars a month in revenues.
3 And we don't know what expenses relate to that
4 revenue figure based on your testimony today; is
5 that right?

6 A. That is correct.

7 Q. Thank you. You mentioned your
8 belief that 30 percent of the customers might be
9 lost in a move of this facility. You said it was a
10 stab in the dark. Is that the closest we can get?
11 Is it just a guesstimate on your part?

12 A. Well again, in my function at the
13 company, you know, I spearheaded the acquisition of
14 13 companies that were just like this. So one of
15 the things we looked at, and I personally spent a
16 lot of time on, was the integration of those 13
17 companies into our company. So one of the things
18 we looked at frequently is can we take four
19 facilities and skinny it down to one facility. But
20 it's very difficult to say in particular, there's
21 no kind of rule of thumb that you are going to lose
22 "X" amount of customers, you just know from
23 experience.

24 You know, again, if you handle it
25 flawlessly, you are going to mitigate the risk of

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2 that. And I would like to say we handle everything
3 flawlessly, but we don't. But even if you do that,
4 you have customers, and that's based on preference,
5 and this is something that I've looked at a lot and
6 have been interested and talked to, again, 13
7 companies. I've talked to their management teams,
8 and I've said, "why do people buy your service, why
9 don't they just go host someplace else." And often
10 times what these entrepreneurs would say is that a
11 big set of their customers want to drive down to
12 their hosting center, see the facility, know who is
13 managing it. And most of the customers, in turn,
14 are small entrepreneurs.

15 Q. Let's talk about the cost of moving.
16 If the company were in fact to reject the lease.
17 There are estimates about the costs that would be
18 incurred in moving to a new facility. Did you
19 prepare those estimates?

20 A. No, I didn't.

21 Q. So you have no personal knowledge of
22 any of the information that would have been
23 compiled to make those estimates?

24 A. No. I got those from the finance
25 department.

1 TRESNOWSKI - CROSS

2 Q. Are you aware that anyone collected
3 estimates for contracts in connection with
4 preparing those estimates?

5 A. I don't know if they did or not.

6 Q. The debtors' objection also states
7 that the replacement value of the improvements that
8 would be installed at a new facility would be five
9 million dollars. Are you aware of that number?

10 A. Yes, I am.

11 Q. Do you help in the preparation of
12 that analysis that resulted in that number?

13 A. No. Again, that was prepared in our
14 financial department.

15 Q. So you have no personal knowledge of
16 the elements of that estimate; is that correct?

17 A. The only knowledge I have is of the
18 facility and what we paid for the company and
19 obviously knowing the improvements they made to it.

20 Q. Of course one question we might ask
21 you, if you were involved in that process, is
22 whether or not the five million dollar estimate
23 included the cost of building equipment that could
24 simply be moved from one location to another
25 location. You don't know the answer to that

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2 question; is that right?

3 A. No, sir, I don't know the precise
4 answer. I know most of the investment is in the
5 facility and the raised floors and security
6 systems.

7 Q. You also don't know, I assume,
8 whether or not this five million dollar figure is
9 based on a build out of premises the size of the
10 debtors' premises or substantially reduced
11 premises, which according to Mr. Pearlman's
12 testimony, might be appropriate. You wouldn't know
13 the answer to that question either, would you?

14 A. If you are asking me to comment on
15 whether we would build substantially reduced
16 premises, I guess, when I heard that testimony, I
17 frankly didn't agree with it, because selling web
18 hosting space in the sense you are selling
19 inventory, your inventory is what you sell? So it
20 would be -- and you also have empty space.

21 Q. Unless of course the value didn't
22 support it.

23 A. There are spaces where the volume
24 doesn't support it, because you have a lack of
25 demand.

1 TRESNOWSKI - CROSS

2 Q. How many customers utilize the space
3 at Kearney Massa?

4 A. I don't know.

5 Q. Do you know that there's been a loss
6 of customers at Kearney Massa?

7 A. I don't think I know.

8 Q. How substantial has been the loss?

9 A. I don't know the exact amount.

10 Q. Has it been substantial as far as
11 you know?

12 A. I believe it has been substantial,
13 that the hosting division has lost substantial
14 customers throughout this division and throughout
15 the turn process.

16 Q. Would you characterize the web
17 hosting business as a core business of Allegiance
18 Telecom?

19 A. Yes. I suppose that depends. Our
20 core business is serving small and medium size
21 businesses. We have other businesses. When we
22 talk about core and non core, we talk about
23 customer segments. So we believe for the core --
24 yet business customer web hosting is an important
25 service. It used to be far more important, because

1 TRESNOWSKI - CROSS

2 fewer people are hosting web sites today.

3 Q. I notice in the existing provision
4 that Allegiance's revenue is something along the
5 lines of 400 thousand dollars plus. How much of
6 that pertains to or is derived from web hosting
7 services?

8 A. It would be a relatively small
9 percent, something in the neighborhood of ten to 15
10 million.

11 Q. What's ten to 15 million as a
12 percentage of 400 million; five percent?

13 A. Again, we don't evaluate the
14 business space on revenue, we base it to the profit
15 and overall cost to the business.

16 Q. What percentage of the 200 million
17 dollar loss does the web hosting space utilize?

18 A. I don't know precisely.

19 MR. GOLDBERG: I have no further
20 questions, your Honor.

21 THE COURT: Do you recall how long
22 it took to move the Chicago hosting business to
23 Boston?

24 THE WITNESS: It was a period of
25 weeks, your Honor. I don't know the exact time

1 TRESNOWSKI

2 frame.

3 THE COURT: And was there revenue
4 lost in connection with that?

5 THE WITNESS: There was revenue lost
6 in connection with that.

7 THE COURT: Do you remember how
8 much?

9 THE WITNESS: I can get that
10 information. I don't have it.

11 THE COURT: Or the percentage?

12 THE WITNESS: I don't have that.

13 THE COURT: To your knowledge, are
14 there similar facilities in San Diego to this one?

15 THE WITNESS: You know, I don't know
16 the answer to that. The only comment I would make
17 is that we have gotten a number of calls from
18 parties in that area showing interest in buying the
19 business. So I don't know if that means there are
20 other facilities in the area or not, but that's the
21 only relevant information I would have.

22 THE COURT: All right.

23 Do you have any questions?

24 MR. HENES: Just redirect, your
25 Honor.

1 TRESNOWSKI - REDIRECT

2 REDIRECT EXAMINATION BY MR. HENES:

3 Q. One option with respect to the
4 hosting business, the sale business --

5 A. Yes.

6 Q. -- if the business were to be sold,
7 can you tell us right now whether the lease would
8 be assumed and assigned or rejected?

9 A. I believe it would be assumed and
10 assigned.

11 Q. Would another option be that the
12 hosting business would be partly reorganized?

13 A. Yes.

14 Q. Is there another option where the
15 business would be shut down?

16 A. That would be unlikely, but I
17 suppose that's an option.

18 Q. Are the debtors currently analyzing
19 all of those options?

20 A. Yes, definitely.

21 Q. Is it fair to say that the debtor is
22 not in a position today to make a determination on
23 what to do with this lease?

24 A. That's correct.

25 MR. HENES: Thank you.

1 ALLEGIANCE TELECOM, INC.

2 THE COURT: Just roughly, how long
3 do you think that analysis will take?

4 THE WITNESS: I think -- I don't
5 think we're far, I think within the next 30 days we
6 would have completed that.

7 THE COURT: And that ties into your
8 plan negotiations?

9 THE WITNESS: Absolutely.

10 THE COURT: Okay.

11 MR. GOLDBERG: No further questions,
12 your Honor.

13 THE COURT: You can sit down.

14 THE WITNESS: Thank you, your Honor.

15 MR. HENES: Your Honor, as Mr.

16 Tresnowski explained, this lease is part of a
17 larger business which is the debtors' hosting
18 business. Mr. Tresnowski, as he explained, said
19 since the business does approximately one million
20 dollars worth of revenue and that there could
21 definitely be loss of business if the debtors were
22 forced to reject the lease today and lease the
23 business, but I don't think that's what's really
24 important here today.

25 I think what's important here today

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2 are two facts: The debtors are current on the
3 rent. As a result of that, the landlord is getting
4 the benefit of it's bargain, the same benefit it
5 could get outside the bankruptcy.

6 Secondly, and most important is, the
7 debtors need more time to determine what to do with
8 the business, whether to sell it or reorganize part
9 of the reorganized debtors, or as it sounded to me,
10 would not be likely to shut the business down
11 altogether. The debtors are working diligently to
12 look at these this leases and all the other leases
13 in the business. And in fact, we are getting a
14 business plan out today to the lenders and
15 creditors' committee so the plan process really can
16 begin in earnest.

17 And I think at this point in time it
18 would have an adverse impact on the contacts were
19 it forced to determine whether to assume or reject
20 the lease. And I think in re Burtby in the Second
21 Circuit case, I think looking at the facts set
22 forth there it is clear that the debtors should be
23 given more time to make a determination on this.
24 The debtors are, as I mentioned, current on rent.
25 The debtors have not had sufficient time to pose a

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2 Chapter 11 plan at this time, whether it's going to
3 be part of that sale and the proceeds are going to
4 be part of the sale, and this is an important asset
5 to the debtors, whether it's going to be an
6 important asset on a going forward basis and
7 maximized value for the debtors' estate.

8 Based on that, your Honor, we
9 believe that the motion should be denied. The
10 debtors should continue to have time to make a
11 determination of whether to assume or reject this
12 lease.

13 THE COURT: Why don't I hear from
14 the committee before you say something.

15 MR. GOLDBERG: Sure.

16 MR. DUBLIN: Phil Dublin for the
17 committee. Your Honor, I don't agree with
18 everything Mr. Henes said with respect to
19 satisfying all the pertinent important elements.
20 We are aware that the debtors are analyzing a
21 number of different possibilities for their hosting
22 business, including a potential sale and using the
23 business in connection with reorganization. We are
24 aware that the debtors are current on rent, and
25 believe that to the extent they were forced to

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2 assume or reject at this time, it would have
3 negative ramifications on the recoveries, whether
4 through a sale or premature assumption.

5 THE COURT: Did Mr. Tresnowski's 30
6 day estimate, while perhaps commendable, sound
7 somewhat optimistic to you?

8 MR. DUBLIN: We are hoping this is a
9 big, big week in Allegiance and hoping to move
10 towards true plan negotiations with respect to the
11 extension on the prejudice and exclusivity for
12 another ten days. I think one option may be
13 available to determine how much more time the
14 business debtors may need to be on this lease is to
15 revisit it in 30 days and see where it is on
16 exclusivity.

17 THE COURT: Okay.

18 MR. GOLDBERG: Your Honor, one
19 clarification; just a couple of remarks. The fact
20 is true that the debtor is current in the payment
21 of its rent, but there are significant prepetition
22 arrearages. So when the debtor states that we
23 would have the same rights in bankruptcy as we have
24 outside, we have greater rights inside bankruptcy
25 than out. There are 75 thousand dollars worth of

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2 roof repairs this debtor was supposed to pay for
3 and did not and were not restrained by the
4 automatic stay, my inclination is that we would be
5 in a different discussion with the debtors these
6 days and that we would have rights.

7 That aside, I would submit to this
8 court that the debtor has thoroughly failed on
9 meeting its burden on this court's earlier order
10 with respect to the extension of time to assume or
11 reject the leases. We did not hear that this lease
12 need be tied in with the plan negotiations, which
13 frankly to an outsider doesn't sound like they've
14 progressed very far and may not for some period of
15 time. If committees' counsel were right, this is a
16 step in the right direction, if we were provided
17 service, we would have been happy to have done it.

18 The debtor put on a witness that
19 says he thinks a million dollars is generated from
20 this site based on some conversations with a CFO
21 who hasn't bothered to show up. No one has
22 testified whether that million dollars is
23 profitable. No one has testified to the cost of
24 moving with any credible evidence. No one has
25 provided any support to the debtors' objection that

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2 it would cost five million dollars to fit another
3 location. There simply has been no evidence at all
4 of the adverse impact of the rejection of this
5 lease on the debtors' estate.

6 Now by the way, if the debtors wish
7 to assume this lease, because as we seem to hear,
8 it's likely that that will be the result either in
9 the sale of the debtor or reorganization, we
10 certainly have no objection to that. That would
11 mitigate our potential damages from losing this
12 tenant. We have no objection to that. We what we
13 do have an objection to is a failure to decide
14 causing the loss of this potential new lease, and
15 then the failure to assume the lease with respect
16 to the debtor. The debtor has not made its case.

17 What the debtor said is that it
18 might take 30 days to move the customers to another
19 location. Well, on August 15th that probably was
20 true. On August 1st that probably was true. And
21 here it is, September 15th, and we are talking
22 about a ten day adjournment and needing 30 more
23 days. That's not fair. The rules are here to
24 protect debtors from not addressing serious
25 problems as they arise. This debtor didn't do it,

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2 it didn't treat this landlord's request with any
3 kind of intelligence, and now we're here having one
4 day left to go before with this new lease. That's
5 not fair.

6 The other thing we heard from this
7 witness today, albeit it wasn't supported by any
8 financial statements or credible statements of
9 profit and loss, is that this location, regardless
10 of its location on the backbone of the debtors'
11 communications network, comprises virtually none of
12 the debtors' revenue; 12 million dollars a year by
13 the debtors' estimate for a 400 million dollar a
14 year company, it's virtually negligible. Its
15 importance to the debtors' business, never mind the
16 importance of the debtors' web hosting to its
17 overall business, never mind the importance of
18 that; and in reorganization, that doesn't pass the
19 bar. It's not credible evidence or any evidence of
20 detriment to the debtor. The only evidence we have
21 is the debtors' frankly slow to non existent
22 behavior in response to our reasonable request to
23 look at the situation, and that, if anything,
24 suggests that we've satisfied the Webtech factor as
25 well.

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2 So in sum, I think the prejudice to
3 the landlord beyond compensation under the
4 Bankruptcy Code is clear. I think the debtors, to
5 the extent it says it needs more time, has waived
6 that right pursuant to its conduct. And there is
7 no evidence before the court that shows that the
8 debtors showed the cause to move order under
9 Section 365(b)(4).

10 MR. HENES: Your Honor, a number of
11 points. First, we are sympathetic to the landlord.
12 We understand their view; we understand this is
13 important to them. We would consider discussing
14 with them taking, although on a short term, the
15 offer that was made to them for the other tenant in
16 the lesser space, which is what the debtors' really
17 need, because the space is vacant. But to get to
18 the main point, I think that Mr. Tresnowski put on
19 evidence that demonstrated the need for more time.
20 We are in the middle of a reorganization. We need
21 to look at this business to make a determination of
22 whether to sell or reorganize, and we are doing
23 that as quickly as possible. And with that, your
24 Honor, I believe the time should be extended.

25 THE COURT: Has the debtor made an

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2 offer to take over the smaller, roughly the 13,000
3 square feet of space for roughly that rent?

4 MR. HENES: Not that I'm aware of; I
5 don't believe so.

6 THE COURT: Okay. But you say you
7 are willing to consider that?

8 MR. HENES: Absolutely.

9 MR. GOLDBERG: Your Honor, that's a
10 completely -- not only is that completely
11 contradictory to what we were previously told about
12 this, but it was completely contradictory to what
13 we were told at the beginning of the hearing. I
14 just hope it's not a ploy for more time just so we
15 don't get an order today. It would be very
16 difficult to complete these negotiations today, and
17 the debtor up to this very moment has shown no
18 interest in talking about it.

19 MR. HENES: Your Honor, Mr.
20 Tresnowski is the one that mentioned that. The
21 debtor would be the one to discuss that. I didn't
22 do that to try to buy time. And Frankly, I don't
23 know how your Honor would rule.

24 THE COURT: There are statements.
25 Mr. Pearlman's point on affidavit was that the

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2 debtors had suggested assuming a lease for the
3 smaller portion, you know, for smaller rent. So
4 I'm just trying to determine whether in fact there
5 have been discussions like that.

6 MR. HENES: It may be the case, your
7 Honor. Mr. Tresnowski and I are not aware. Mr.
8 Pearlman --

9 THE COURT: This is directed to both
10 counsel: Are either of you aware of any cases in
11 this context that discuss harm to the landlord
12 beyond the term of the lease, i.e. opportunity,
13 cost to the landlord versus simply being able to
14 have the benefit of the original barring of the
15 lease?

16 MR. GOLDBERG: No, your Honor.
17 There are no cases that we are aware of on that
18 point.

19 MR. HENES: I'm not aware of any.

20 THE COURT: Okay. I'll be back at
21 11:30.

22 MR. GOLDBERG: Thank you, your
23 Honor.

24 (Recess taken.)

25 THE COURT: Please be seated.

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2 While this isn't an easy issue, I'm
3 going to deny the motion for the following reasons:
4 I believe the debtor has shown cause for an
5 extension of time, or of the continued extension of
6 its time to assume or reject the San Diego lease.
7 I have two somewhat contradictory Second Circuit
8 precedences, the most recent of which is the Klone
9 Smith decision which shows the importance to assume
10 or reject the lease and the grave consequence for
11 creditors in a decision to assume the lease. And
12 the focus there currently under the Second Circuit
13 was the burden was on the whole estate and all of
14 the creditors.

15 I also have a number of cases
16 dealing with the criteria for cause to extend the
17 60 day period. And while this is a motion to
18 terminate the 60 day period the for cause, the
19 standard still applies. I think the most relevant
20 case in the high authority still being the Burn
21 Newbury case. But each one of these cases is
22 unique and I'm directed to apply balance and test
23 based on the facts in front of me. Those facts
24 show that the debtor is currently paying for the
25 use of the premises and will continue to do so.

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2 Second, that the debtor I believe has not had
3 sufficient time to formulate either a determination
4 of the value of the lease to it, and more
5 importantly, to formulate a plan.

6 Mr. Tresnowski's testimony was
7 credible, that while I believe the hosting business
8 is not the core business in and of itself for the
9 debtor, it is an important strategic aspect of its
10 business and the service that the debtor provides
11 to its customers. And the debtor is in the midst
12 of analyzing and negotiating with its creditor
13 constituents how it wants to proceed with that
14 business. And I believe that while the debtors'
15 inability to give the landlord a degree of
16 certainty on the lease is obviously frustrating to
17 the landlord, I don't believe the debtor has been
18 dilatory in pursuing the plan analysis that
19 underlies what it is to do with the lease. The
20 lease, and more importantly the hosting business is
21 a primary asset of the debtors in the sense that
22 again it affects the debtors' strategic analysis,
23 essentially its business plan.

24 It is clear that the landlord does
25 have a substitute tenant, so obviously the denial

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2 of the landlord's request here does have the
3 potential effect of damaging the landlord in the
4 event that the debtor ultimately rejects the lease.
5 However, to balance that potential harm to the
6 landlord, I note the following: First, the offer
7 that the landlord has is not for the full 28,000
8 plus square foot premises, but for roughly 13,000
9 thousand square feet of that which covers the
10 portion of the premises that really reflects the
11 build out and improvements testified to by Mr.
12 Tresnowski.

13 Secondly, I think that the primary
14 focus should be on the litigation for the remaining
15 term of the lease as opposed to further opportunity
16 costs, which are more speculative in my mind. So
17 there is roughly two years to run on the lease. I
18 think that one can assume that the debtor will
19 continue to occupy the premises for at least a few
20 months pending confirmation of the plan. And Mr.
21 Tresnowski has testified that of the three
22 potential outcomes here in respect of the lease,
23 the least likely is that the lease will be
24 rejected. The more likely outcome will be either
25 that the hosting business continues under the plan

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2 with the eventual assumption of the lease, or that
3 the business will be sold with, again, the
4 assumption of the lease.

5 He testified that they had received
6 offers and expressions of interest on the hosting
7 business, including the business in San Diego. And
8 obviously the landlord will have the ability to
9 veto an assumption of the lease if the lease is not
10 cured in full. But again, in comparison to what
11 the landlord has today, which also is not a full
12 assumption of the lease but rather an assumption of
13 13,000 out of 28,000 square feet at a slightly
14 reduced rent of what the debtor is paying, it does
15 not seem to me that the case has been made that the
16 landlord will be significantly harmed by losing
17 this opportunity today. So when I weigh that
18 factor, which obviously is an important factor in
19 favor of the landlord as against the ongoing plan
20 determinations, and the fact that the debtor is
21 current and will continue to be current on the rent
22 of what today is remaining two years lease term, I
23 think that the balance tips slightly in favor of
24 the debtor. So therefore the debtor has shown
25 cause here.

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2 Added to that, I would say that the
3 actual costs to both sides are pretty sketchy,
4 frankly, from the record which both witnesses had
5 conative views but used the term guesstimate or
6 best guess about four on five times. So I'm really
7 basing my decision less on the cost amounts set
8 forth in the debtors' response on the aspects of
9 Mr. Tresnowski's testimony which was clear and
10 convincing, which is that this is a high quality
11 facility, at least the portion dealing with the
12 hosting business, which as far as I can tell is the
13 portion that the perspective new tenant wants to
14 assume, and that when I weigh the premium that the
15 clients put on the court in making these decisions
16 in a reasonable and careful manner versus the harm
17 to the landlord, which is clear in my mind but not
18 clearly extensive or significant, I come out on the
19 side of the debtor.

20 So I think Mr. Henes, you should
21 settle an order on the landlord.

22 MR. HENES: Yes, your Honor.

23 MR. GOLDBERG: Thank you, your
24 Honor.

25 MR. HENES: Thank you, your Honor.

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C E R T I F I C A T E

STATE OF NEW YORK }
 } ss.:
COUNTY OF WESTCHESTER)

I, Denise Nowak, a Shorthand
Reporter and Notary Public within and for
the State of New York, do hereby certify:

That I reported the proceedings in
the within entitled matter, and that the
within transcript is a true record of such
proceedings.

I further certify that I am not
related, by blood or marriage, to any of
the parties in this matter and that I am in
no way interested in the outcome of this
matter.

IN WITNESS WHEREOF, I have
hereunto set my hand this _____ day of
_____, 2003.

DENISE NOWAK