Philip D. Anker (PA 7833)
Adam C. Dembrow (AD 2142)
WILMER, CUTLER & PICKERING
399 Park Avenue
New York, New York 10022
(212) 230-8800

Attorneys for Verizon Communications Inc. and its operating telephone company subsidiaries.

Hearing Date: June 23, 2003
Objection Deadline: June 18, 2003

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

LIMITED OBJECTION OF VERIZON COMMUNICATIONS INC. AND ITS OPERATING TELEPHONE COMPANY SUBSIDIARIES TO DEBTORS' MOTION FOR FINAL ORDER AUTHORIZING USE OF CASH COLLATERAL

Verizon Communications Inc. and its operating telephone company subsidiaries (collectively, "Verizon") submits this Limited Objection to the pending Motion of the Debtors for Entry of a Final Order Authorizing the Debtors' Use of Cash Collateral (Docket No. 21) (the "Cash Collateral Motion"). In support of this Limited Objection, Verizon states as follows:

Background

1. On May 14, 2003 (the "Petition Date"), Allegiance Telecom, Inc. and certain of its subsidiaries (collectively, the "Debtors") filed voluntary petitions for relief under Chapter 11 of Title 11 of the United States Code (the "Bankruptcy Code"). Pursuant to Sections 1107(a) and 1108 of the Bankruptcy Code, the Debtors continue to operate their businesses and manage their affairs as Debtors-in-Possession.

2. The Debtors describe themselves as "a national local exchange carrier that provides integrated telecommunications products and services to small and medium-sized business customers, large businesses (i.e., national customers with multiple locations), governmental entities, wholesale customers and other institutional users." Utilities Motion, ¶¶ 3-4. The Debtors state that they have more than 100,000 such customers. Id. at ¶ 2. They tout themselves as "critical" and "integral" to federal telecommunications policy. ("Federal policy recognizes the importance of facilities-based CLECs and Allegiance is the model. In that regard, the Federal Communications Commission (the "FCC")… stated that "Allegiance is the blueprint for local competition proposed by the FCC.") Id. at ¶ 7 (emphasis in original).

3. The Debtors are competitive local exchange carriers ("CLECs), created by the Telecommunications Act of 1996, that rely upon existing or "incumbent" local exchange carriers ("ILECs") as critical wholesale service providers supporting the Debtors' CLEC business. Verizon is one such ILEC.

4. In fact, Verizon is evidently the largest trade creditor of the Debtors and the largest provider of telecommunications services to the Debtors. The Schedule of the top 40 Unsecured Creditors in this case filed by the Debtors lists eight separate Verizon accounts (each of which is large enough to make the top 40 and four of which are in the top 10) for an aggregate prepetition debt of approximately $35,000,000.00 owed by the Debtors to Verizon. By Verizon's calculations, it is in fact owed at least approximately $60,493,000.00 as of the Petition Date. Moreover, the average billings from Verizon to the Debtors have been running at nearly $8,000,000.00 per month, and there is no reason to date to think that this dollar amount will decrease materially postpetition.

5. The Debtors, in turn, use the telecommunications services furnished by Verizon not only for their own communications needs, but as a critical component of the Debtors' telecommunications business. Indeed, the Debtors have acknowledged that their ability to continue in business and provide telecommunications services to their end user customers is "dependant" upon the services they obtain from Verizon and other telecommunications providers. See Motion of the Debtors Pursuant to §§ 105(a) and 366 of the Bankruptcy Code for an Order Deeming the Utilities Adequately Assured of Future Performance and Establishing Procedures for Determining Requests for Additional Adequate Assurance (the "Utilities Motion"), ¶ 39 (May 14, 2003).

6. The Debtors have also acknowledged, and this Court has found, that without the use of cash collateral subject to the alleged liens of the Debtors' bank lenders, "none of the Debtors' estates would have necessary funds to satisfy their respective obligations." See Emergency Interim Order Authorizing the Use of Cash Collateral by Consent (May 15, 2003) (the "Cash Collateral Order"), ¶ G. Accordingly, the Debtors have filed a motion, with the consent of their bank lenders, for authority to use cash collateral under Section 363 of the Bankruptcy Code. At the outset of this case, the Court entered the Interim Cash Collateral Order authorizing such use on an emergency basis.

7. That Order expressly recites that substantially all of the Debtors' assets are subject to the liens of the bank lenders. It also makes clear that the cash on hand -- approximately $250,000,000.00 -- is substantially less than the amount owed to the banks: $465,300,000.00 plus interest, fees, costs and expenses. Thus, were the bank lenders to prohibit any use of the Debtors' cash and, after obtaining relief from the stay, apply that cash to their claims, it appears that there would be no excess cash (or any other assets in this case) available to

satisfy postpetition administrative expense claims (other than those of the professionals who have negotiated a carve-out for their sole benefit).

8. In this regard, the Interim Cash Collateral Order allows the Debtors to use the bank's cash collateral but subject to substantial restrictions. Among other such restrictions, the Interim Cash Collateral Order expressly prevents any use of cash collateral "for any purposes" upon an event of default (defined in the Interim Cash Collateral Order as a "Termination Event"). It thus provides that "[t]he Debtors' right to use Cash Collateral . . . shall . . . expire on . . . the occurrence of a Termination Event." Interim Cash Collateral Order ¶ 4. If that were no sufficiently clear, the Interim Cash Collateral Order also specifies that "[i]n no event shall the Debtors be authorized to use Cash Collateral for any purposes or under any terms other than those set forth herein and as set forth in the Budget or as may otherwise be approved by this Court. . . ." Id.

9. The Interim Cash Collateral Order defines a "Termination Event" broadly:

> Notwithstanding anything to the contrary in this Interim Order, a Termination Event shall occur, unless cured by the Debtors or waived by the Agent and Requisite Lenders, (a) upon the fifth (5th) business day following the delivery of written notice to the Debtors by the Agent of any breach or default by the Debtors of the terms and provisions of this Interim Order, including, but not limited to (i) failure to furnish to the Agent those reports and information listed in Paragraphs 3 and 17 of this Interim Order, (ii) noncompliance with the Budget as defined in Paragraph 2 of this Interim Order, unless with respect to each of the foregoing, the Debtors have cured such breach or default with such five (5) business day period; and (b) without notice of any kind upon (i) the failure to maintain the Minimum Cash Balance as required by Paragraph 3 of this Interim Order, (ii) the failure to make any payment to or for the Agent on behalf of itself or the Lenders as required by the Interim Order, (iii) the conversion of the chapter 11 case to a chapter 7 case or appointment of a trustee without the consent of the Agent and (iv) the initiation of a lawsuit or adversary proceeding by the Debtors (excluding any lawsuit or proceeding relating to the Disputed Amount and the Disputed

> Account) seeking to challenge the validity or priority of (or to subordinate) any of the Agent's and the Lenders' liens and security interests on any of the Collateral, unless waived by the Agent at the direction of the Required Lenders.

Interim Cash Collateral Order ¶ 18 (emphasis added).

10. The Debtors have also moved to deem all of their telecommunications and other utility providers, including Verizon, adequately assured under Section 366 of the Bankruptcy Code. In the Utilities Motion, the Debtors do not offer to provide any deposits or makes any prepayments to Verizon or any other utility providers, but rather offer them a mere administrative expense claim which would presumably be subordinate to the superpriority administrative claim granted to the bank lenders in the event of any diminution in the value of their cash collateral (such as if the Debtors continue postpetition to incur substantial losses as they have prepetition). 11 U.S.C. § 507(b); Interim Cash Collateral Order ¶ 8.

Limited Objections

11. Verizon recognizes that the Debtors need to use cash collateral to continue to operate. It nevertheless files this Limited Objection and respectfully submits that any Final Cash Collateral Order should be subject to the following three conditions:

12. First, the Debtors have not provided Verizon (or, to Verizon's knowledge, any other creditor) a draft of the proposed Final Cash Collateral Order. The Debtors should be required to do so. Without having had an opportunity to review that proposed order, Verizon files this Limited Objection to reserve its rights.

13. Second, Verizon objects to the Final Cash Collateral Order to the extent, like the Interim Cash Collateral Order, it requires the Debtors immediately to cease using all cash upon an event of default, even if the Debtors are required to continue to operate and need cash to do so to meet their lawful regulatory requirements. The Debtors and the bank lenders have not made

any allowance for the fact that the Debtors, as regulated CLECs providing service to the public, cannot, by law, immediately cease their service provision without reasonable notice to their end user customers. As set forth more fully in Verizon's Request for Adequate Assurance under Section 366(b), federal and state regulations would prohibit a CLEC telecommunications provider, such as the Debtors, from discontinuing service to its end-user customers unless the Debtors had first obtained authorization from the federal and state regulatory agencies having jurisdiction over the Debtors' activities. See Request of Verizon Communications Inc. and Its Operating Telephone Company Subsidiaries for Adequate Assurance of Future Payment Pursuant to Sections 105(a) and 366(b) of the Bankruptcy Code (the "Adequate Assurance Request"), ¶ 38. The Telecommunications Act, for example, provides in pertinent part that "[n]o carrier shall discontinue, reduce or impair service to a community, or a part of a community, unless and until there shall have first been obtained from the [FCC] a certificate that neither the present nor future public convenience and necessity will be adversely affected thereby. . . . 47 U.S.C. § 214(a). The implementing regulations adopted by the FCC would require, at a minimum, the Debtors to give at least 30 days written notice to their end users of any plan to discontinue service.[1/] Some states require even longer notice periods, including New York in

---

[1/] While the Debtors tout the FCC's acknowledgment of their role in the competitive telecommunications industry, the Debtors and their bank lenders are proposing a Cash Collateral Order that would almost certainly violate federal law and FCC rules. Under the relevant FCC regulations, the Debtors, as a domestic nondominant carrier, may not cease providing interstate services without special authorization from the FCC. If they have filed an acceptable FCC application and issued an end user notification at least thirty (30) days prior to service withdrawal, such authorization is deemed to have been granted on the thirty-first day, unless the FCC determines that public convenience and necessity require otherwise. See 47 C.F.R. § 63.71. however, as in recent cases, the FCC will act to delay the service discontinuance beyond the minimum 30 days prescribed under its regulations when impacted end users raise valid service issues. See, e.g., In re e.spire Application to Discontinue Domestic and International Telecommunications Services, FCC Order, Comp. Pol. File No. 592, 2002 WL 1782176 (Aug. 2,

which the Debtors operate, which generally requires 60 days advance notice to end-users and 90 days advance to the State Public Utilities Commission.

14. Thus, were the Debtors to default under the Cash Collateral Order, and be given five business days by the bank lenders to cease all use of Cash Collateral, the Debtors still would be required, as a matter of law, to continue to provide service to their end-users on a longer transitional basis. For the Debtors to so serve their end-users, Verizon and other utility telecommunications providers whose services are necessary must also continue to serve the Debtors. As noted, those services amount to some $8,000,000.00 per month from Verizon alone. No Cash Collateral Order should be entered in this case that prevents the Debtors from satisfying their obligations under law or forces Verizon or others to continue to provide service postpetition without any prospect of payment. See 28 U.S.C. § 959 (debtor-in-possession must comply with all applicable state laws affecting its property); 11 U.S.C. § 366 (utility is entitled to "adequate assurance of payment"). Rather, the Cash Collateral Order should conform to the requirements of the Debtors' legal status as regulated CLECs - the same legal status that attracted the bank lenders to lend to the Debtors in the first place. The Cash Collateral Order should permit the Debtors, even if there is a Termination Event, to continue to use the cash to the extend necessary for the Debtors to meet all of their regulatory obligations for public notice and service withdrawal and to pay for all services provided by Verizon and other utility providers during such period as the Debtors are required by law to continue to provide service to their end users. In the alternative, the Cash Collateral Order should require the bank lenders to give Debtors

---

2002) (denying application to discontinue service with respect to certain customers, until such customers have "a reasonable period of time," not to exceed an additional 29 days, to migrate to other carriers); In re Telergy Network Services, inc., et al., Section 63.71 Joint Application to Discontinue Domestic Telecommunications Services, FCC Order, NSD File No. W-P-D 547, 2002 WL 47030 (Jan. 14, 2002) (extending the 30 day notice period for at least eight more days).

sufficient notice of cessation of Debtors' rights to use the Cash Collateral - certainly more than five and at least thirty business days - to provide a reasonable a lawful cessation of Debtors' service to the public. At the same time, in order to minimize the need for the Debtors to continue to use the Cash Collateral after default while maintaining some capability to meeting their legal obligations with respect to service withdrawal, the Debtors should be required to provide a meaningful deposit and/or prepayments such that Verizon has "adequate assurance" of payment as required under Section 366(b).

15. Third, the Cash Collateral Order should not waive the estate's rights under § 506(c) of the Bankruptcy Code to surcharge the bank lenders' collateral for the administrative expenses incurred in preserving that collateral. Under Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A., 530 U.S. 1 (2000), such a waiver could preclude any claim under § 506(c). The Interim Cash Collateral Order provides for a waiver of the Debtors' § 506(c) rights. It specifies that "[s]o long as the Lenders are consenting to or otherwise providing use of Cash Collateral and except as expressly provided herein, no expenses of administration of the Debtors' estates shall be charged pursuant to section 506(c) of the Bankruptcy Code, or otherwise, against the Collateral or any collateral supporting the Replacement Liens. Interim Cash Collateral Order ¶ 15. Although this provision in the Interim Cash Collateral Order appears to apply only while the lenders are permitting the use of cash collateral, Verizon has not been provided a copy of any proposed Final Cash Collateral Order and therefore has no assurance that this "limitation" will continue. Moreover, even if the proposed Final Cash Collateral Order contains the same "limitation," the language appears to provide for an absolute waiver of § 506(c) rights so long as the lenders are permitting of some minimal cash collateral, even if that amount is insufficient to

pay all administrative expenses, including those owing to Verizon or others that directly benefit the lenders.

16. The Debtors have acknowledged that the postpetition services provided by Verizon are absolutely critical to the Debtors' efforts to continue in business and reorganize, the principal beneficiaries of which would appear to be the bank lenders who cannot expect to recover in full in a liquidation from the Debtors' cash and other limited assets. If the Debtors fail to pay for the postpetition services they obtain from Verizon, or if the lenders do not subsequently permit the use of cash collateral to pay for those services, the Debtors should not be barred from exercising their statutory right to surcharge the lenders' collateral to pay for such services as their fiduciary and statutory duties would require them to do. That is especially so in a case such as this one in which the Debtors have offered no meaningful adequate assurance of payment to Verizon for the critical postpetition services it provides.

17. In even less compelling circumstances many courts have prohibited the waiver by a debtor of § 506(c) rights in cash collateral or other financing orders. See In re Brown Brothers, Inc., 136 B.R. 470, 474 (W.D. Mich. 1991) (holding that provision in cash collateral order purporting to waive right to surcharge collateral under § 506(c) "is not enforceable in light of the congressional mandate that a trustee have the authority to use a portion of secured collateral for its preservation or proper disposal"); In re Willingham Investments, Inc., 203 B.R. 75, 80 (Bankr. M.D. Tenn. 1996) (sustaining objection to provision in cash collateral order that would have effectively prohibited any surcharge of collateral under § 506(c)); In re Ridgeline Structures, Inc., 154 B.R. 831, 832 (Bankr. D.N.H. 1993) (holding unenforceable provision in cash collateral order prohibiting surcharge under § 506(c)).

WHEREFORE, Verizon requests that the Court deny the Debtors' Motion for entry of a Final Cash Collateral Order unless the concerns raised by Verizon herein are addressed in that Order.

Dated: June 18, 2003

Respectfully Submitted,

/s/ Philip D. Anker
Philip D. Anker (PA 7833)
Adam C. Dembrow (AD 2142)
Wilmer, Cutler & Pickering
399 Park Avenue
New York, New York 10022
(212) 230-8800

Attorneys for Verizon Communications Inc. and its operating telephone company subsidiaries.