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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

HEARING DATE: 6/23/03
AT: 10:00 A.M.

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In re: : Chapter 11
: Case No. 03-13057 (RDD)
ALLEGIANCE TELECOM, INC., ET AL., : (Jointly Administered)
: Debtors.
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**REPLY TO VERIZON'S LIMITED OBJECTION TO DEBTORS' MOTION
FOR FINAL ORDER AUTHORIZING USE OF CASH COLLATERAL**

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

Allegiance Telecom, Inc. and its direct and indirect subsidiaries, as debtors and debtors-in-possession (collectively, "Allegiance" or the "Debtors"), by their co-bankruptcy counsel, Togut, Segal & Segal LLP, submit this reply to the limited objection (the "Limited Objection") of Verizon Communications Inc. and its operating telephone company subsidiaries (collectively, "Verizon") to the Debtors' motion for entry of a final order authorizing the use of cash collateral, and respectfully state that:

PRELIMINARY STATEMENT

1. On May 15, 2003, the Court entered an interim order (the “Interim Cash Collateral Order”) authorizing the Debtors’ use of cash collateral to pay their reasonable and necessary operating expenses incurred in the ordinary course of business. The hearing to consider entry of the final order (the “Final Cash Collateral Order”) is scheduled for June 23, 2003.

2. In addition to the Limited Objection, Verizon filed its request for additional adequate assurances pursuant to section 366 of the Bankruptcy Code (the “366 Request”). Contemporaneous herewith, the Debtors have filed their objection to the 366 Request (the “366 Objection”). As set forth in the 366 Objection, Verizon is not entitled to additional adequate assurances because the Debtors have sufficient cash to pay their operating expenses, the Debtors have use of their cash collateral pursuant to the Interim Cash Collateral Order, the Debtors have, and will continue to pay, their postpetition operating expenses, including Verizon’s charges as they come due. Additionally, the Debtors have substantial claims against Verizon for prepetition services rendered on behalf of Verizon. Moreover, as stated in the 366 Objection, more than ninety percent (90%) of Verizon’s billings are issued in advance of the services provided, not in arrears. This factor alone, minimizes substantially Verizon’s risk of non-payment during the post-petition period.

3. Verizon, which is also a direct competitor of the Debtors, objects to the Debtors’ use of cash collateral pursuant to the terms of the Final Cash Collateral Order on the grounds that the Final Cash Collateral Order prohibits the use of cash upon a default by the Debtors and the Debtors waived their rights under section 506(c) of the

Bankruptcy Code to surcharge the lenders' collateral for administrative expenses incurred in preserving collateral.¹

4. Verizon's Limited Objection should be overruled. Verizon's rights against the Debtors are governed and protected by section 366 of the Bankruptcy Code; it should not be permitted to obtain additional leverage by objecting to the Debtors' use of cash collateral. As set forth in the 366 Objection, Verizon is not subject to unreasonable risk of non-payment and is not entitled to additional protections other than administrative expense treatment under the Bankruptcy Code. Accordingly, the Debtors respectfully request that the Court overrule the Limited Objection and enter the Final Cash Collateral Order.

REPLY

5. Verizon objects to the provision in the Final Cash Collateral Order that prevents the use of cash collateral upon an event of default. Verizon's Limited Objection at ¶ 13. Verizon states that because an event of default would cause the immediate termination of cash collateral use, it is theoretically at risk of incurring additional charges without any ability to get paid – a risk shared by all administrative expense creditors.

6. The Cash Collateral Order does not give the prepetition lenders greater termination rights than those that existed under the prepetition credit agreement. Under the prepetition credit agreement, upon an event of default the prepetition lenders were entitled to terminate funding without notice. In contrast, the Final Cash Collateral Order provides the Debtors, under certain situations, with five

¹ Additionally, Verizon requested that the Debtors' provide it with a copy of the proposed Final Cash Collateral Order. Verizon's Limited Objection at ¶ 12. A copy of the proposed Final Cash Collateral

business days notice of default and the ability to cure such default. This five-day notice period also provides the Debtors with the ability to seek Court authorization for, among other things, the use of cash collateral on a non-consensual basis. Nothing in the Final Cash Collateral Order prohibits the Debtors from seeking the Court's authority to use cash collateral pursuant to section 363(c)(2)(B).

7. Equally unavailing is Verizon's argument that after a termination it could be required to provide services for an additional month without compensation due to FCC requirements that prohibit termination of services without proper notice to customers.² As noted above, Verizon's advance billings give it protection in the event of a default. As a practical matter, if the Debtors were forced to give additional notice to terminate service, the Debtors' customers would be obligated to pay for such additional service. At that time, the Debtors, their creditors and other parties in interest would determine which entity is entitled to the proceeds. Verizon is now seeking a determination from the Court that it should receive a superpriority claim for all its charges. Verizon is not entitled to any additional protections than those provided under section 366.

8. Verizon also objects to the Debtors' waiving the estate's rights under section 506(c) of the Bankruptcy Code to surcharge the bank lenders' collateral for administrative expenses incurred in preserving that collateral. Verizon's Limited Objection at ¶ 15. The section 506(c) waiver contained in the Final Cash Collateral Order is a requirement imposed by the prepetition lenders as a condition to the Debtors' consensual use of cash collateral. In addition, pursuant to the Supreme Court holding in

Order has been provided to Verizon's counsel.

² To the extent that this risk exists postpetition, it is no different from the same risk that such FCC regulations would have presented prepetition.

Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 14 (2000), only the Debtors have a right to asserts rights under section 506(c) of the Bankruptcy Code. Verizon does not have standing to assert rights under section 506(c) and can not contest the Debtors' waiver of such rights. Moreover, the Final Cash Collateral Order makes clear that the Debtors will continue to possess section 506(c) rights if the lenders are no longer consenting to the use of cash collateral. Final Cash Collateral Order at ¶ 15. Accordingly, upon a default, the Debtors would have the right to surcharge the lenders' collateral for the benefit of their estates.

WHEREFORE, the Debtors respectfully request that the Court overrule Verizon's Limited Objection, enter the Final Cash Collateral Order and grant such other and further relief as is just and proper.

Dated: New York, New York
June 20, 2003

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

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