**Hearing Date and Time: October 21, 2003 at 10:00 a.m.**
**Objection Deadline: October 16, 2003 at 5:00 p.m.**

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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| In re: | : | Chapter 11 |
| | : | Case No. 03-13057 (RDD) |
| ALLEGIANCE TELECOM, INC., ET AL., | : | (Jointly Administered) |
| Debtors. | : | |

**DEBTORS' OBJECTION TO MOTION OF SAN DIEGO GAS & ELECTRIC COMPANY, COMMONWEALTH EDISON COMPANY AND SOUTHERN CALIFORNIA EDISON COMPANY (A) TO VACATE UTILITIES ORDER AND (B) TO DETERMINE ADEQUATE ASSURANCE OF FUTURE PAYMENT**

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 objection to the motion dated August 1, 2003 (the "Motion to Vacate") of San Diego Gas & Electric Company ("SDG&E"), Commonwealth Edison Company ("ComEd") and Southern California Edison Company[1] ("SCE," and together

[1] Southern California Edison Company joined the Motion to Vacate on August 13, 2003.

with SDG&E and ComEd, the "Movants") (a) to vacate the Utility Order (defined below) and (b) to determine adequate assurances of future payment, and respectfully state that:

## PRELIMINARY STATEMENT

1. On May 14, 2003 (the "Petition Date"), the Debtors filed a motion pursuant to sections 105(a) and 366(b) of the Bankruptcy Code for an order (a) deeming the Debtors' utilities (the "Utility Companies") adequately assured of future payment and (b) establishing procedures for determining requests for additional adequate assurance (the "Utility Motion"). On May 15, 2003, this Court entered an order granting the Utility Motion (the "Utility Order"). A copy of the Utility Order is attached hereto as Exhibit "1".

2. Among other things, the Utility Order: (i) directed the Utility Companies to provide postpetition services to the Debtors without the need for any postpetition deposits or prepayments; (ii) directed the Debtors to pay, on a timely basis, in accordance with prepetition practices, all undisputed invoices for postpetition invoices from the Utility Companies; (iii) provided the Utility Companies with an administrative expense priority claim under sections 503(b) and 507(a)(1) of the Bankruptcy Code for any unpaid postpetition utility services used by the Debtors; and (iv) established a procedure for the Utility Companies to request additional assurances of payment within 25 days of the date of the Utility Order.

3. On May 21, 2003, the Debtors served the Utility Order on approximately 300 Utility Companies, including the Movants.

4. On June 26, 2003, the Court entered the Amended Final Order Authorizing Use of Cash Collateral By Consent (the "Cash Collateral Order"), which authorizes, among other things, the Debtors to use their cash collateral to pay their necessary

operating expenses, including the Utility Companies' postpetition charges as and when they are due.

5. During June 2003, each of the Movants, with the exception of SCE, sent Additional Assurances Requests to the Debtors seeking two to four month deposits.[2] The Debtors advised the Movants that the Additional Assurances Requests were unreasonable under the circumstances and, on August 1, 2003, the Movants filed the Motion to Vacate.

6. In addition to seeking deposits, the Motion to Vacate seeks to vacate the Utility Order (i) because this Court entered it as a "first day" order without prior notice to the Movants and (ii) because it allegedly grants unauthorized injunctive relief by prohibiting the Movants from terminating utility services to the Debtors in accordance with state regulatory procedures absent further order of the Court.[3]

7. The Motion to Vacate is without merit and should be denied in its entirety. The procedures set forth in the Utility Order, which were complied with by the Debtors and are substantially similar to the procedures in other utility orders entered in chapter 11 cases, provided the Movants with ample notice and an opportunity to be heard.

8. Moreover, the Utility Order does not enjoin the Movants from pursuing their rights under state tariff laws. It simply provides for a procedural requirement, i.e., that the Utility Companies first obtain an order from this Court before proceeding to commence the process of terminating services in the event of a postpetition default. Under these procedures, the Debtors and other parties in interest will have notice of such default and the imminent termination of services so that the interests of the estate can be safeguarded.

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[2] SDG&E seeks a deposit in the amount of $74,392, ComEd in the amount of $11,465, and SCE in the amount of $42,120.

[3] Presumably, the Movants seek to vacate the Utility Order only as it applies to them. The Movants do not have standing to vacate the Utility Order as to the other Utility Companies.

9. As set forth in the Affidavit of Christine B. Kornegay in Support of Debtors' Objection, dated October 13, 2003 and filed herewith (the "Kornegay Affidavit"), the Debtors have more than $274 million in cash on hand, have use of their cash in accordance with the Cash Collateral Order, are paying their postpetition undisputed bills timely, and have an excellent prepetition and postpetition payment history to the Utility Companies. Accordingly, and as set forth more fully below, the Debtors respectfully request that the Court deny the Motion to Vacate in its entirety.

## BASIS FOR THE DEBTORS' OBJECTION

### A. The Utility Order Does Provide the Movants With Notice and an Opportunity to Be Heard

10. The Movants first argue that the Utility Order should be vacated because they did not have any "appreciable notice and an opportunity to be heard" on the Utility Motion "because the Movants were not served with the Utility Order until after it had been entered by the Court." Motion to Vacate, p. 7.

11. This argument is without merit. This Court has already determined that "proper notice of the [Utility Motion] was given under the circumstances." Exhibit "1", p. 1. Although the Utility Companies did not receive prior notice of the Utility Motion, they are protected by the Utility Order itself, which provides a mechanism whereby each Utility Company receives notice of, and an opportunity to be heard, regarding the relief granted therein. See ¶ 3, *supra*., Moreover, the Utility Order was a first-day order of a type routinely entered in chapter 11 cases in this Court and throughout the country. The Debtors provided notice of the Utility Motion, and a host of other first-day motions, to the Debtors' prepetition lenders, the *Ad Hoc* Committee of Noteholders and the United States Trustee. Such notice is sufficient to obviate Movant's concerns that notice was not given.

12. Indeed, the Utility Order specifically provides that the Utility Order "is without prejudice to the rights of any Utility Company to request in writing within 25 days of the date hereof, additional assurances in the form of deposits or other security." Exhibit "1", p. 3. The procedures set forth in the Utility Order are interim in nature; only if a Utility Company fails to make a timely request for additional assurance do they ripen and preclude the Utility Company from challenging whether adequate assurance has been provided. Id. On the other hand, if a Utility Company makes a timely Additional Assurance Request, it is then deemed to have adequate assurance of payment "unless or until this Court enters a final order to the contrary." Id.

13. As such, any Utility Company that makes an Additional Assurances Request that is refused by the Debtors is then prohibited from altering, refusing or discontinuing service to, or discriminating against the Debtors pending the outcome of the resulting Determination Hearing. In accordance with its terms, the Debtors served the Utility Order on all of the Utility Companies within five (5) days of its entry, or May 21, 2003. The Utility Companies, including Movants, were free to contest the Utility Order by its own terms.

14. The Movants next argue that the Utility Order should be vacated because service was not affected in accordance with Bankruptcy Rules 7004 and 9014. Specifically, the Movants complain that the Debtors did not serve the Utility Order to the attention of an officer, managing or general agent. The alleged harm was that the Movants were unable to serve their Additional Assurances Request within 25 days of entry of the Utility Order. However, this point is moot because the Debtors do not raise the timeliness of Movant's notice.

**B. The Utility Order Does Not Improperly Grant Injunctive Relief**

15. The Movants assert that the Utility Order essentially granted the Debtors injunctive/equitable relief, without the procedural safeguards of an adversary proceeding pursuant to Bankruptcy Rule 7001(7), by requiring the Movants to seek Court approval before terminating service pursuant to state tariff laws on account of a postpetition default by the Debtors. See Motion to Vacate, p. 8. In essence, the Movants take the position that upon the Debtors furnishing a Utility Company with adequate assurance, section 366(b) enjoins a utility company from discontinuing utility services only on account of prepetition defaults and not postpetition defaults. Thus, the Movants contend that the Utility Order should be vacated because: (i) it was not brought by adversary proceeding in accordance with Bankruptcy Rule 7001; (ii) the Debtors did not set forth any legal or factual basis for injunctive relief; and (iii) the injunctive relief deprives the Utility Companies of their rights under applicable state law.

16. Section 366 of the Bankruptcy Code provides as follows:

> (a) Except as provided in subsection (b) of this section, a utility may not alter, refuse or discontinue service to, or discriminate against, the trustee or the debtor solely on the basis of the commencement of a case under this title, or that a debt owed by the debtor to such utility for service rendered before the order for relief was not paid when due.
>
> (b) Such utility may alter, refuse or discontinue service if neither the trustee nor the debtor, within 20 days after the date of the order for relief, furnishes adequate assurance of payment, in the form of a deposit or other security, for service after such date. On request of a party in interest and after notice in a hearing, the court may order reasonable modification of the amount of the deposit or other security necessary to provide adequate assurance of payment.

11 U.S.C. § 366.

17. The language of section 366(b) of the Bankruptcy Code reveals that when bankruptcy courts find adequate assurance of payment, the utility is enjoined from terminating services. Section 366(b) provides that if the debtor does not provide adequate assurance of payment within the specified period of time, the utility may refuse or discontinue providing service to the Debtor. Stated in the negative, if the debtor does furnish adequate assurance of payment, the utility may not discontinue services without seeking court approval -- even if for a failure to pay postpetition amounts.

18. The Movants' position that section 366(b) should be read to prohibit discontinuance of utility services only on account of the prepetition defaults would require the Court to add words to section 366(b) that are not present, as follows:

> Such utility may alter, refuse, or discontinue service **[solely on the basis of the commencement of a case under this title or that a debt owed by the debtor to such utility to service rendered before the order for relief was not paid when due]**, if neither the trustee nor the debtor, within twenty (20) days after the date of the order for relief, furnishes adequate assurance of payment, in the form of a deposit or other security, for service after such date.

19. Notably, section 366(b) only provides one instance in which a utility can terminate service. The one instance is when adequate assurance is not provided – which is not the case here. Therefore, it is section 366(b) and not the Court that enjoins termination in all other instances. Here, by finding that adequate assurance is provided, section 366(b) enjoins termination of service.

20. In Marion Steel Co. v. Ohio Edison (In re Marion Steel Co.), 35 B.R. 188, 200-01 (Bankr. N.D. Ohio 1983), a utility attempted to defend its right to terminate unilaterally under state law without bankruptcy court approval if the chapter 11 debtor defaulted postpetition. 35 B.R. at 92. The debtor asserted that termination was stayed until the utility

obtained relief from the bankruptcy court. Id. The court ruled that, implicit in its power to set adequate assurance under section 366 of the Bankruptcy Code, it could enjoin the unilateral termination even in the event of a postpetition default:

> The utility's antagonistic struggle to contest the injunction against utility shut-off . . . seems much ado about nothing. The utility, while incensed over the specter of any type of court interference with a unilateral right to shut-off by way of a Rule 65 injunction, must surely realize that the terms and conditions of "adequate assurance of payment", which this Court must set under § 366, may well entail, as part of the Court's equitable power, an injunction against unilateral shut-off.

Id. at 200. Actually, the Court was simply triggering the injunction in section 366(b).

21. In Hobbs v. Summit House Condominiums (In re Hobbs), 26 B.R. 488 (Bankr. E.D. Pa. 1982), the court enjoined a condominium association providing utility services to the debtors from terminating services based on late postpetition payments. 20 B.R. at 490. After ruling the condominium association was a utility under section 366, the court was extremely restrictive of the associations' options in the event of a postpetition default: "Since we conclude that a utility . . . may only demand adequate assurance of future payment of utility bills, in exchange for the continuation of that utility service, we find that the defendants threatened actions were impermissible." Id.

22. In In re Robmac, 8 B.R. 1, 4 (Bankr. N.D. 1979), the focus of the dispute was the amount of the deposit demanded by the utility of the chapter 11 debtor. 8 B.R. at 1. The court restricted the utility's remedies after the initial 20-day period to making a motion in bankruptcy court for relief to terminate. Id. at 4.

23. Notably, if utilities could circumvent a bankruptcy court's setting of adequate assurance by using state tariff laws to unilaterally terminate services, the expedited procedures set forth by the United States Court of Appeals for the Second Circuit in Caldor

would be rendered useless. In Caldor, the Second Circuit affirmed the bankruptcy court's setting of adequate assurance of payment under section 366(b) by, among other things, establishing expedited procedures in bankruptcy court in the event the debtors were to default on postpetition payments to the utilities. 117 F.2d at 652. Thus, by ordering the utilities to proceed in bankruptcy court in the event of a postpetition payment default, Caldor contemplated that utilities may not use state tariff laws to terminate services without bankruptcy court approval. Id. at 649.

24. Moreover, the Utility Motion was made not only pursuant to section 366, but also pursuant to section 105(a) of the Bankruptcy Code. Courts have frequently used section 105(a) of the Bankruptcy Code[4] to enjoin creditors from terminating services to chapter 11 debtors if such termination would cause harm to the debtor's estate. See, e.g., Data-Link Sys., Inc. v. Whitcomb & Keller Mortgage Co. (In re Whitcomb & Keller Mortgage Co.), 715 F.2d 375 (7th Cir. 1983) (bankruptcy court properly restrained creditor from discontinuing essential computer services to debtor); U.S. Rural Electrification Admin. V. Wabash Valley Power Ass'n, Inc. (In re Wabash Valley Power Ass'n, Inc.), 167 B.R. 885, 888 (S.D. Ind. 1994) ("bankruptcy courts have the authority in section 105 to preclude creditor from exercising contract right"); In re Amber Lingerie, Inc., 30 B.R. 736, 737 (Bankr. S.D.N.Y. 1983) (debtor entitled to injunction preventing cancellation of the insurance policy by insurer); see also, Marion Steel, 35 B.R. at 195 ("at or after the time the court holds it 366(b) hearing, the Court holds that its equitable power under § 366 embellished by its 11 U.S.C. § 105 power . . . permits

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[4] Section 105(a) provides in pertinent part:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

11 U.S.C. § 105(a).

it to fashion . . . an appropriate remedy, including injunctive relief, without following all the formal procedures of Rule 65 Fed. R. Civ. P.").

25. Moreover, contrary to the Movants' assertion, the Debtors set forth the basis for injunctive relief in the Utility Motion as follows:

> If the Utility Companies are permitted to terminate Utility Services on the 21st day after the Commencement Date, the Debtors would be forced to cease operations, resulting in a substantial loss of revenues and assets of the Debtors' estates and effectively undermining the Debtors' reorganization efforts. In addition, any termination of service would cause significant harm to the Debtors' customers and the public switched telephone network. Accordingly, an interruption of the Utility Services in these chapter 11 cases would severely disrupt the Debtors' business operations, resulting in irreparable harm to the Debtors' restructuring efforts. It is therefore critical for the Debtors and their customers, that Utility Services be uninterrupted.

Utility Motion, p. 18.

26. In the alternative, the Debtors respectfully submit that the Utility Order does not grant injunctive relief nor does it enjoin the Utility Companies from proceeding with their state law tariff rights. It simply prescribes a procedural requirement, i.e., the Utility Companies must obtain an order from this Court permitting termination of services, before they may exercise their rights. Utility Companies cannot engage in their other remedies until they have complied with this requirement because to allow them to unilaterally terminate service would jeopardize the entire reorganization to the substantial prejudice of all creditors.

### C. The Movants Are Adequately Assured of Future Payment and Do Not Need a Deposit

27. Each of the Movants requests that this Court grant them adequate assurance in the form of a security deposit. The Debtors contend that the Movants are adequately assured of payment. Debtors have paid Movants in a timely fashion in the past and

continue to do so postpetition. To tie up the Debtors' funds so it can sit in escrow accounts held by the Movants makes no sense.

28. Pursuant to section 366(b) of the Bankruptcy Code, this Court may determine the standards for adequate assurance of future payments for utility services. Determinations of adequate assurance under section 366 of the Bankruptcy Code are fully within the Court's discretion. See Virginia Elec. & Power Co. v. Caldor, Inc. (In re Caldor), 117 F.3d 646, 650 (2d Cir. 1997); In re Adelphia Bus. Solutions, Inc., 280 B.R. 63, 81 (Bankr. S.D.N.Y. 2002). See also In re Begley, 41 B.R. 402, 405-406 (E.D. Pa. 1984), aff'd, 760 F.2d 46 (3d Cir. 1985) ("[S]ection 366(b) vests in the bankruptcy court the exclusive responsibility for determining the appropriate security which a debtor must provide to his utilities to preclude termination of service for non-payment of prepetition utilities bills").

29. "Adequate assurance" under section 366 of the Bankruptcy Code is not synonymous with "adequate protection." In determining what constitutes adequate assurance, the court is not required to give the utilities the equivalent of a guaranty of payment, but must only determine that the utility is not subject to an unreasonable risk of nonpayment for postpetition services. See Adelphia, 280 B.R. at 80; In re Caldor, Inc.-NY, 199 B.R. 1, 3 (S.D.N.Y. 1996); Massachusetts Elec. Co. v. Keydata Corp. (In re Keydata Corp.), 12 B.R. 156, 158 (1st Cir. B.A.P. 1981).

30. Whether a utility is subject to an unreasonable risk of nonpayment must be determined by examining the totality of the circumstances and making "a particularized inquiry into the postpetition economics of a debtor's chapter 11 case." See Adelphia, 280 B.R. at 82-83. Further, in making a determination as to the need for any additional postpetition deposits, the court should ensure that the utility is treating the debtor the same as it would treat a

similarly situated, non-bankruptcy debtor. See In re Whitaker, 84 B.R. 934, 942 (Bankr. E.D. Pa. 1988), aff'd, 882 F.2d 791 (3d Cir. 1989).

31. Moreover, courts have recognized that requiring a debtor to allocate valuable liquidity for a deposit to provide further adequate assurance effectively can "prejudice the unsecured creditor body for the benefit of a single one." In re Magnesium Corp. of America, 278 B.R. 698, 713-714 (Bankr. S.D.N.Y. 2002).

32. The Second Circuit has held that where, as here, debtors have generally timely paid their undisputed utility bills prior to the commencement of their chapter 11 cases, the administrative expense priority provided in sections 503(b) and 507(a)(1) of the Bankruptcy Code constitutes adequate assurance of payment, and no deposit or other security is required. See Virginia Elec. & Power Co. v. Caldor, Inc., 117 F.3d 646 (2d Cir. 1997). See also In re Demp, 22 B.R. 331, 332 (Bankr. E.D. Pa. 1982); In re Shirley, 25 B.R. 247, 249 (Bankr. E.D. Pa. 1982) ("[S]ection 366(b) of the [Bankruptcy] Code does not permit a utility to request adequate assurance of payment for continued services unless there has been a default by the debtor on a prepetition debt owed for services rendered.").

33. As stated by Judge Gerber in the bench decision in In re Global Crossing, Ltd., "the practice in the Southern District of New York, and in large cases, at least in this district, has not been to routinely require deposits." See Transcript of Global Crossing bench decision, attached hereto as Exhibit "2", p. 30. Instead, it is appropriate to engage "in a more fact driven analysis . . . focusing on the ultimate question, whether, as a matter of fact, given the unique circumstances of the particular case and the totality of those circumstances, whether the utilities have adequate assurance that they will be paid for their postpetition services." Id. at 30-31.

34. As of August 31, 2003, the Debtors had over $274 million in cash on hand; since the Petition Date, the Debtors' cash on hand has increased by $25 million. See Kornegay Affidavit, ¶ 5. Moreover, the Debtors are authorized to use their cash pursuant to the Cash Collateral Order to pay, among other things, operating expenses payable to utilities and, indeed, the Cash Collateral Order provides the Debtors, their estates and creditors with greater protections than what was afforded under the prepetition credit agreement. Under certain circumstances, the prepetition credit agreement gave the lenders the ability to exercise their state law setoff rights automatically and without notice upon an event of default. The Cash Collateral Order requires the lenders to give five business days notice to the Debtors and the Committee before taking action and, accordingly, gives the Debtors and their creditors, including the Movants, greater protection than what was available under the prepetition credit agreement. Finally, the Debtors have timely paid all of Movants' undisputed postpetition invoices. See generally Kornegay Affidavit. In light of these factors, the Debtors submit that Movants are not entitled to additional adequate assurances of payment.

35. The Movants attempt to distinguish Caldor by, among other things, asserting that the Debtors' hiring of outside consultants to address their financial problems and assist them with a business plan indicates that the Debtors face an extremely uncertain future. See Motion to Vacate, p. 12. However, chapter 11 debtors routinely hire outside consultants to assist the reorganization. If anything, outside consultants increase the chance of a successful reorganization.

36. Movants next allege that "the Debtors' own counsel is uncertain about the Debtors' ability to pay their bills . . . as they have obtained a carve-out in the Cash Collateral Order to ensure payment of those postpetition bills." Motion to Vacate, p. 12. Therefore, the Movants "should be entitled to security for providing the Debtors with essential postpetition

services." Id. This point is entirely irrelevant. Among other things, however, professionals only receive 80% of amounts billed to the Debtors on a monthly basis, pending approval of such fees by the Court. The Movants have received, and will continue to receive, 100% of their bills for postpetition services. Thus, the Debtors' professionals are not in the same position as the Movants.

37. Further, the Movants argue that they should be entitled to a deposit because under the Movants' billing cycles the Debtors could receive 2 to 2 1/2 months of unpaid service before their service could be terminated for postpetition payment default. See Motion to Vacate, p. 15. However, the same would be true prepetition.[5] The Movants should not be put in a better position simply because of the filing of the petition.

38. The vast majority, if not all, of the prepetition arrears owed to Movants is attributable to invoices issued by the Movants after the Petition Date that could not be paid due to the automatic stay. Moreover, prepetition obligations are not a significant factor in determining whether a utility is adequately assured of postpetition payment. See Adelphia, 280 B.R. at 86 (citing In re Global Crossing, Ltd., No. 02-40188 (REG)).

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[5] Only one of the Movants, SCE, holds a prepetition deposit.

WHEREFORE, the Debtors request that the Motion to Vacate be denied in its entirety and that this Court grant such other and further relief as is just and proper.

Dated: New York, New York
October 16, 2003

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Debtors and Debtors-in-Possession,
By their Co-Bankruptcy Attorneys,
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