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

Hearing Date: February 19, 2004, at 10:00 a.m.
Objection Date: February 17, 2004, at 4:00 p.m.

Attorneys for the telephone operating company subsidiaries of Verizon Communications Inc.

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 THE TELEPHONE OPERATING COMPANY SUBSIDIARIES OF VERIZON COMMUNICATIONS INC. TO DEBTORS' MOTION FOR ORDERS PURSUANT TO SECTIONS 105(a), 363, 365 AND 1146(c) OF THE BANKRUPTCY CODE: (A)(I) FIXING THE TIME, DATE AND PLACE FOR THE BIDDING PROCEDURES HEARING AND (II) APPROVING THE NO-SHOP PROVISIONS SET FORTH IN THE ASSET PURCHASE AGREEMENT WITH QWEST COMMUNICATIONS INTERNATIONAL INC.; (B)(I) ESTABLISHING BIDDING PROCEDURES AND BID PROTECTIONS IN CONNECTION WITH THE SALE OF SUBSTANTIALLY ALL OF THE ASSETS OF THE DEBTORS, (II) APPROVING THE FORM AND MANNER OF NOTICES, (III) APPROVING THE ASSET PURCHASE AGREEMENT SUBJECT TO HIGHER AND BETTER OFFERS AND (IV) SETTING A SALE APPROVAL HEARING DATE; AND (C)(I) APPROVING THE SALE TO QWEST COMMUNICATIONS INTERNATIONAL INC. FREE AND CLEAR OF ALL LIENS, CLAIMS AND ENCUMBRANCES, (II) AUTHORIZING THE ASSUMPTION AND ASSIGNMENT OF CERTAIN EXECUTORY CONTRACTS AND UNEXPIRED LEASES AND (III) GRANTING RELATED RELIEF

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

The telephone operating company subsidiaries of Verizon Communications Inc. (collectively, "Verizon"), by and through their undersigned counsel, file this Limited Objection

to the above-styled motion of the Debtors, dated December 18, 2003 (the "Sale Motion"). In support thereof, Verizon states as follows:

BACKGROUND

1. Pursuant to the Sale Motion, Debtors seek to sell substantially all of their assets. Although Qwest Communications was the stalking horse bidder, the Debtors have just announced that XO Communications was the winning bidder at the auction. See www.allegiancetelecom.com.

2. As part of the Sale Motion, the Debtors seek authority to assume and assign various executory contracts, none of which the Debtors have specified. Indeed, the Sale Motion and the Debtors' bidding procedures require that the contracts to be assumed and assigned remain secret until 20 days prior to the hearing on confirmation of the Debtors' chapter 11 plan. The Debtors have not yet filed any such plan.

3. Verizon is a party to numerous executory contracts with the Debtors. Pursuant to those contracts, Verizon provides various telecommunications services to the Debtors without which the Debtors have acknowledged they could not service their customers and continue in business. 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, dated May 14, 2003, ¶ 39. There are large outstanding defaults by the Debtors under these agreements. Verizon has filed a proof of claim in these cases for more than $60 million, representing the outstanding prepetition balance owing to it under these contracts. This amount would have to be paid by the Debtors in order to cure the defaults under the agreements for those agreements to be assumed and assigned.

OBJECTIONS

4. For the most part, the Debtors appear to propose to address the assumption and assignment process at a later date. Thus, except in the event of an "Early Closing Election," they propose to identify the executory contracts to be assumed and assigned, and to specify the amounts they believe they must pay to cure any defaults thereunder, 20 days before the confirmation hearing, with the closing of the sale to occur only after confirmation. See Order (A) Establishing Bidding Procedures and Bid Protections in Connection With the Sale of Substantially All of the Assets of the Debtors, (B) Approving the Form and Manner of Notices and (C) Setting a Sale Hearing Date, dated January 15, 2004, ¶ 17. However, the order (the "Sale Order") that the Debtors now ask this Court to enter granting the Sale Motion appears in several respects to cut-off or adversely affect the rights of Verizon and other counter-parties to any executory contracts that the Debtors may propose to assume and assign. It is those objectionable provisions that are the focus of this Limited Objection.

5. The Sale Order contains seven paragraphs addressing the assumption and assignment of executory contracts, each of which purports to afford the Debtors relief and affect the rights of Verizon and other counter-parties to such contracts. Since the Debtors have not identified a single executory contract they seek to assume or assign, each of these provisions should be stricken, so as to preserve everyone's rights. In particular, several of the provisions are objectionable.

6. Paragraph 12 of the Sale Order, for example, specifies that "the Debtors' assumption and assignment to Buyer and Buyer's assumption on the terms and conditions set forth in Purchase Agreement of the Assumed Contracts is hereby approved, provided that the requirements of section 365(b)(1) of the Bankruptcy Code with [sic] are satisfied as set forth in

the Debtors [sic] Notice of Intent to Assume and Assign . . ." Verizon and every other counter-party to an executory contract should have the right to contest whether any contract can or should be assumed and assigned. But, because the Debtors have failed to identify the contracts they intend to assume and assign, no one can meaningfully do so now. To the extent that the current language of this sentence is designed to preserve the rights of Verizon and other counter-parties to contest whether the requirements for assumption and assignment of any contract have been met, then (a) the whole sentence is meaningless and should be stricken or (b) language should be added making this reservation of rights absolutely clear.

7. As written, paragraph 13 of the Sale Order is also objectionable. It provides, supposedly "in accordance with sections 105(a) and 365 of the Bankruptcy Code," for the assumption and assignment of executory contracts free and clear of any liens, claims, encumbrances, and "interests of any kind or nature whatsoever." Section 365 authorizes no such relief. And, while Section 363 may permit the sale of the Debtors' contractual rights free and clear of any liens of third parties in those rights, it most surely does not permit the vitiating of any rights of Verizon or other counter-parties to such contracts.

8. Paragraph 14 of the Sale Order is also objectionable to the extent that it paraphrases – incorrectly – Section 365(k) of the Bankruptcy Code. Paragraph 14 states that "pursuant to section 365(k) of the Bankruptcy Code, the Debtors shall be relieved from any further liability with respect to the Assumed Contracts after . . . assignment to and assumption by Buyer." But that is not what Section 365(k) says. All it states is that the assumption and assignment of an executory contract or unexpired lease relieves the debtor of liability for any "breach of such contract or lease occurring after such assignment." 11 U.S.C. § 365(k). Thus, the Debtors can be relieved of liability following any assumption and assignment only for breaches that occur after

the closing. They will remain liable after the closing for any pre-closing breaches. Indeed, as noted earlier, the Debtors specifically propose that the cure issues will not be resolved and payment of any disputed cures will not occur until after the assignment has occurred. The Debtors' incorrect paraphrasing of Section 365(k) should be stricken.

9. Paragraph 15 of the Sale Order parrots the language of Section 365(b)(1) of the Bankruptcy Code that any defaults under any contracts to be assumed and assigned will be "promptly cured." But, in fact, the Sale Order would authorize the Debtors to close on the sale, and to assign contracts to the buyer, even if any disputes over the proper cure amounts remain pending and without establishing any meaningful procedures for the prompt resolution of those disputes and payment in full of the required cures. Thus, paragraph 17 of the Sale Order merely requires the Debtors, by the date of any assumption and assignment, to pay any undisputed cure amounts and to segregate the funds required to pay any disputed cure amounts pending the resolution, by a date nowhere specified, of the dispute. In light of this procedure, the Debtors propose that the Sale Order decree that "the fact that any Cure Amount Objection is not resolved shall not prevent or delay the occurrence of the date of assumption or the assumption and assignment of any Assumed Contracts, and the objectors' only recourse after the relevant date of assumption shall be to the segregated amounts." That is contrary to law. Section 365(b)(1)(A) requires that, as a condition to assumption, the Debtors must cure or provide adequate assurance that they will "promptly" cure any default. Nothing in the procedures the Debtors ask this Court to bless assures a prompt cure of defaults.

10. Paragraph 16 of the Sale Order is also objectionable. First it states that "[w]ith the exception of the Cure Amounts, except as otherwise set forth herein, each nondebtor party to an Assumed Contract hereby will be forever barred, estopped, and permanently enjoined from

asserting against the Debtors or Buyer, or the property of any of them, any default existing under the Assumed Contracts . . ." Section 365(b)(1), of course, requires more than the mere cure of any defaults; it also requires, among other things, that the Debtors compensate the non-debtor party for any pecuniary loss. And, where, as here, the Debtors propose to assign an assumed agreement, the proposed assignee must also provide adequate assurance of performance. 11 U.S.C. § 365(f)(2)(B). To the extent that the Debtors purport in this sentence in the proposed order to alter these or any other statutory requirements or rights of Verizon and other counter-parties, they cannot do so. And, if that is not their intent, then the sentence is meaningless and, again, should be stricken.

11. The second sentence of paragraph 16 is even more troublesome. It specifies that "[a]ll parties that provide telecommunications services pursuant to a tariff related to any of the Sale Assets are hereby directed to continue providing such services to Buyer." To the extent that the Debtors are seeking through this sentence to require Verizon or any other party that provides tariffed facilities and services to continue to do so after the sale even if there has been no assumption and assignment of the tariffed service arrangements and cure of defaults, the provision is unlawful and must be stricken. Tariffs are routinely incorporated by reference as part of interconnection and other agreements that are unquestionably executory contracts. However, services and facilities that are provided solely pursuant to a tariff are provided pursuant to an executory contract – the governing contractual terms are embodied in the tariff, and the contract for particular tariffed arrangements is created by the submission and acceptance of a tariff service order and remains executory in nature until a disconnection order is properly issued and processed. See, e.g., Cahnmann v. Sprint Corp., 133 F.3d 484, 487 (7th Cir. 1998) ("The terms and conditions of service are set forth in 'tariffs,' which are essentially offers to sell

on specified terms, filed with the FCC and subject to modification or disapproval by it . . . . What this means is that the filed tariff is the contract between the [customer] and [the utility]."); Biddle v. Mountain States Tel. & Tel. Co., 629 F.2d 571, 572 (9th Cir. 1980) ("the written tariffs on file with the Arizona Corporations Commission form only a part of the contract for telephone services. The contract between the parties did not arise until... requests for telephone services were made and Mountain Bell... agreed to supply them."); MCI Telecommunications Corp. v. TCI Mail, Inc., 772 F.Supp. 64, 66 (D.R.I. 1991) ("MCI's contractual relationships with its customers are governed by MCI Tariff FCC No. 1."); 64 Am. Jur. 2d *Public Utilities* §61 (2003) ("A tariff that has been approved by a public service commission becomes law and has the same force and effect as a statute enacted by the legislature; it amounts to a binding contract between the utility and its customer[.]"); 86 C.J.S. *Telecommunications* §73 (2003) ("Generally, a tariff is to be viewed as a contract between the company and its customers, affirmed, on behalf of the customers, by the public service commission."). Further, it is clear that these contracts are executory. An executory contract is a contract "under which the obligations of both the debtor and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing performance of the other." TTS, Inc. v. Citibank, N.A. (In re TTS, Inc.), 158 B.R. 583, 588 (D. Del. 1993) (internal citations omitted). Here, Verizon has the continuing obligation to provide the Debtors with access to the network service arrangements provided by tariff, and the Debtors have the continuing obligation to pay for the use of those service arrangements, unless and until the Debtors issue proper cancellation orders. Indeed, the Debtors seemingly acknowledge as much because in the asset purchase agreement they negotiated with Qwest, they defined the "Cure Amounts" to be paid to incumbent local exchange carriers, including Verizon, as including amounts owing "under

tariffs." See Asset Purchase Agreement by and among Allegiance Telecom, Inc. and the Other Sellers Named Herein, Jointly and Severally as Sellers and Qwest Communications International Inc. as Buyer, dated December 18, 2003, § 3.5(a). There is thus no basis in law for the last sentence of paragraph 16. And there certainly is no basis for this Court to include such a sentence purporting to require all counter-parties to continue to provide tariffed services even if the contractual arrangement has not been assumed and assigned, without full briefing or any factual record and without this Court having an opportunity to consider whether, as to any particular such tariff or service, there is or is not an executory contract. The sentence amounts to overreaching and should be stricken.

12. Finally, paragraph 18 of the Sale Order is objectionable to the extent that it provides for the Debtors to pay all ILEC Cure Amounts "(whether in cash or by application of the ILEC Set Off Amounts) subject to and as set forth in Section 3.5 of the Purchase Agreement." Section 3.5 specifies that "all pre-Petition accounts receivable of Sellers owed by ILECs (the 'ILEC Set Off Amounts') shall be set off against the ILEC Cure Amounts and thereby used as currency to pay the ILEC Cure Amounts." But, as a matter of law, the Debtors do not have the right to choose which of their debts are set-off against any amounts owed by any counter-party to an executory contract. If, for example, (a) a creditor has pre-petition claims totaling $20 million, $10 million under one contract and another $10 million under another, (b) the creditor, in turn, owes the debtor $10 million in prepetition debt under neither contract, and (c) the Debtors seek to assume one of the two contracts, the creditor has the right to set-off its $10 million claim arising under the contract not to be assumed against its $10 million debt and insist that the debtor pay the remaining $10 million debt arising under the contract to be assumed in cash. That is the meaning of Sections 506 and 553 preserving the right of a "creditor" to set-off any prepetition

claim against any prepetition debt, and treating any setoff claim as fully secured. Either this provision of Section 3.5 should be stricken or the Sale Order should not approve it (meaning that both paragraphs 3 and 36, which approve all terms of the Purchase Agreement, and paragraph 18 must be changed).

13. In short, under the guise of supposedly preserving the rights of counter-parties to executory contracts to later litigate any cure or related assumption and assignment issues, the Debtors have in fact tried in the Sale Order to vitiate or minimize those rights in numerous ways. The Sale Order should be revised substantially to make it truly neutral and to preserve all rights of counter-parties such as Verizon with respect to any proposed assumption and assignment.

WHEREFORE, Verizon requests that the Court deny the Sale Motion unless the proposed Sale Order is revised to address the concerns set forth herein and to fully preserve all of Verizon's and other counter-parties' rights with respect to any proposed assumption and assignment of any executory contract or unexpired lease. Verizon also reserves all rights to object any proposed cure amounts or any other terms of any proposed assumption and assignment of any Verizon contracts.

Dated: February 17, 2004
New York, New York

WILMER CUTLER PICKERING LLP
399 Park Avenue
New York, New York 10022
(212) 230-8800

By: /s/ Philip D. Anker
Philip D. Anker (PA 7833)

Attorneys for the telephone operating company subsidiaries of Verizon Communications Inc.