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ATTORNEYS FOR THE DEBTORS

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE:	**§**	
	§	
VARTEC TELECOM, INC., *et al.,*	**§**	**CASE NO. 04-81694-SAF-11**
	§	
DEBTORS.	**§**	**(Chapter 11)**
	§	**(Jointly Administered)**

MOTION TO AUTHORIZE REJECTION OF
SCHEDULES 1, 5, 6, AND 7 OF MASTER LEASE AND BRIEF IN SUPPORT
(PBX TELEPHONE EQUIPMENT AT ADDISON I AND II)

TO THE HONORABLE STEVEN A. FELSENTHAL CHIEF BANKRUPTCY JUDGE:

A HEARING WILL BE CONDUCTED ON THIS MATTER ON APRIL 13, 2005, AT 1:30 P.M. IN COURTROOM OF THE HONORABLE STEVEN A. FELSENTHAL, 1100 COMMERCE STREET, 14TH FLOOR, DALLAS, TEXAS. IF YOU OBJECT TO THE RELIEF REQUESTED, YOU MUST RESPOND IN WRITING, SPECIFICALLY ANSWERING EACH PARAGRAPH OF THIS PLEADING. UNLESS OTHERWISE DIRECTED BY THE COURT, YOU MUST FILE YOUR RESPONSE WITH THE CLERK OF THE BANKRUPTCY COURT WITHIN TWENTY (20) DAYS FROM THE DATE YOU WERE SERVED WITH THIS PLEADING. YOU MUST SERVE A COPY OF YOUR RESPONSE ON THE PERSON WHO SENT YOU THE NOTICE; OTHERWISE, THE COURT MAY TREAT THE PLEADING AS UNOPPOSED AND GRANT THE RELIEF REQUESTED.

The above-referenced debtors and debtors in possession (collectively, the "Debtors")[1] file this Motion to Authorize Rejection of Schedules 1, 5, 6, and 7 of Master Lease and Brief in Support (PBX Telephone Equipment at Addison I and II) (the "Motion") and in support thereof the Debtors would show as follows:

JURISDICTION AND PROCEDURAL BACKGROUND

1. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157. This Motion concerns the administration of the estate; and therefore, it is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A).

2. Venue is proper in this Court pursuant to 28 U.S.C. §§ 1408 and 1409.

3. On November 1, 2004 (the "Petition Date"), the Debtors each filed a voluntary petition for relief (collectively, the "Cases") under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code").

4. Since the Petition Dates, the Debtors have continued to operate and manage their businesses as debtors in possession pursuant to Bankruptcy Code §§ 1107(a) and 1108.

5. The Debtors' Cases are jointly administered under the case styled *In re VarTec Telecom, Inc.*, Case No. 04-81694-SAF-11.

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[1] The Debtors include VarTec Telecom, Inc., Excel Communications Marketing, Inc., Excel Management Service, Inc., Excel Products, Inc., Excel Telecommunications, Inc., Excel Telecommunications of Virginia, Inc., Excel Teleservices, Inc., Excelcom, Inc., Telco Communications Group, Inc., Telco Network Services, Inc., VarTec Business Trust, VarTec Properties, Inc., VarTec Resource Services, Inc., VarTec Solutions, Inc., VarTec Telecom Holding Company, VarTec Telecom International Holding Company, and VarTec Telecom of Virginia, Inc.

STATEMENT OF FACTS

VarTec and Its Businesses

6. VarTec Telecom, Inc., a Texas corporation, ("VarTec") along with its sixteen direct and indirect domestic subsidiaries, each of which is a Debtor, and four remaining non-debtor direct and indirect foreign subsidiaries (collectively, the "VarTec Entities"),[2] is among the largest privately held companies providing telecommunications services in North America. The VarTec Entities, founded in DeSoto, Texas in February 1989, with current employees totaling over 1,100 in the aggregate (including approximately 800 in the Dallas metroplex), sell a full range of telecommunication products and services to customers. In 2003, the VarTec Entities had revenues of approximately $1,260,000,000, and anticipate 2004 revenue in the approximate amount of $800,000,000. As of the Petition Date, VarTec's revenues had been derived primarily from three sale distribution channels: (a) Direct Marketing; (b) Commercial Services; and (c) Multi-Level Marketing.

7. The Direct Marketing channel, managed by VarTec and certain of its subsidiaries offers telecommunications services to small business and residential consumers, including local and long distance telephone services, wireless telephone services, and internet access. VarTec pioneered the "10-10 dial-around" long distance market by offering customers the opportunity to access VarTec's discounted long

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[2] Pursuant to that certain Order Approving Sale of Assets (Shares of VarTec Europe) Free and Clear of All Liens, Claims, Rights, Interests, and Encumbrances and Granting Related Relief [Docket No. 586] entered on December 17, 2004, VarTec Telecom International Holding Company sold all of the outstanding ordinary shares of VarTec Telecom Europe Limited and VarTec Telecom Belgium SPRL owned by it. This sale resulted in the disposition by VarTec of fourteen of its non-debtor indirect foreign subsidiaries.

distance services on a call-by-call basis by dialing “10-10” then a three-digit unique carrier access code. Under the “dial-around” model, a customer’s long distance usage is billed on her local phone service provider’s invoice, the local phone service provider collects the billed amounts, and the local phone service provider remits those collected amounts to VarTec.

8. While experiencing tremendous success with the “dial-around” model, VarTec began to offer other telecommunication services, including local and traditional long distance telephone services, wireless telephone service, and internet access, directly to small business and residential customers. VarTec is licensed to provide local and long distance telephone services in all fifty states, and marketed its products and services through, among other means, direct mail and magazine insert campaigns composed of several hundred million items to persons in a targeted market each year. VarTec also uses outbound telemarketing for targeted campaigns to attract new customers of existing products and to offer new and/or additional products to existing customers.

9. The Commercial Services channel, managed by VarTec Solutions, Inc. (formerly known as eMeritus Communications, Inc.) and certain of its subsidiaries (collectively, “VarTec Solutions”), provides customized voice, data, and internet services to commercial and wholesale carrier customers throughout the U.S. VarTec Solutions’ voice product offerings include switched and dedicated access, domestic and international toll-free service, calling cards, audio conferencing, and other specialized products. In addition, VarTec Solutions offers high-capacity data services that provide access to frame relay and IP networks. For carrier customers, VarTec Solutions offers

the ability to co-locate their equipment inside carrier-class facilities, saving the cost and complications involved with building their own facilities.

10. Through the Multi-Level Marketing channel, which was managed by Excelcom, Inc. and certain of its subsidiaries (collectively, "Excel"), Excel offered telecommunications products and services to small business and residential consumers similar to those offered by VarTec to its customers. Excel, which was acquired by VarTec in 2002, had an international network of over 106,000 independent representatives (collectively, the "IRs") who marketed Excel's products and services to small business and residential consumers and recruited new independent representatives to market such products and services. Each independent representative received commissions and bonuses based on, among other things, the success of the independent representatives recruited and a portion of the success of their recruits (referred to as a "downline") and the usage of Excel products and services by customers of the independent representative and a portion of their downline. On March 1, 2005, the Court entered its Order [Docket 1026] authorizing the rejection of the Debtors' executory contracts with each of the IRs.

Secured Debt

11. VarTec is a borrower and the other Debtors (except VarTec Telecom of Virginia, Inc. and Excel Telecommunications of Virginia, Inc.) are guarantors under that certain First Amended and Restated Credit Agreement with the Rural Telephone Finance Cooperative (the "RTFC"), pursuant to which the existing secured indebtedness owing to the RTFC was restructured in the form of a secured term loan and a secured

line of credit to the Debtor.3 The secured line of credit is in the form of a revolving credit facility, for the working capital, credit, and liquidity needed by the Debtor to conduct general business operations. As of the Petition Date, the obligations to the RTFC consisted of (a) a term loan of approximately $154,000,000 and (b) a revolving line of credit with a total commitment of $70,000,000.

<u>Schedules 1, 5, 6, and 7 of the Master Lease with Verizon Credit, Inc.</u>

12. On April 19, 1996, Excel Management Service, Inc. ("EMS") and Verizon Credit, Inc. ("Verizon"), as successor in interest to GTE Leasing Corporation, executed a Master Lease, a copy of which is attached hereto as **<u>Exhibit</u>** **<u>A</u>**. The Master Lease provides certain basic terms common to each schedule executed in connection therewith, and the schedules contain specific provisions identifying, among other things, the equipment being leased, the term of the agreement, and the amount of periodic payments to be made. Excelcom, Inc. guaranteed EMS's performance of its obligations under the Master Lease.

13. EMS and Verizon executed Schedule 1 dated April 19, 1996 ("Schedule 1"), Schedule 5 dated September 19, 1996 ("Schedule 5"), Schedule 6 dated December 31, 1996 ("Schedule 6") and Schedule 7 dated September 2, 1997 ("Schedule 7" and together with Schedule 1, Schedule 5, and Schedule 6, the "Agreements"). A copy of Schedule 1, Schedule 5, Schedule 6, and Schedule 7 are attached hereto as **<u>Exhibits</u>** **<u>B</u>** through **<u>E</u>**, respectively.

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[3] The capital stock of VarTec Telecom of Virginia, Inc. and Excel Telecommunications of Virginia, Inc. was pledged to the Rural Telephone Finance Cooperative under transactions completed in conjunction with the Credit Agreement.

14. Under Schedule 1, Verizon leased to EMS certain equipment and software utilized in connection with the Debtors' PBX telephone system at the location referred to as Addison II (the "Addison II Equipment") for an initial term of eighty-four months commencing on April 19, 1996. Upon the expiration of the initial term of Schedule 1, that schedule was renewed for a twelve-month period, and upon the expiration of that period, for successive monthly periods. The current rent under Schedule 1 is $7,797.18 per month.

15. Under Schedule 5, Schedule 6, and Schedule 7 (collectively, the "Addison I Schedules"), Verizon leased to EMS certain equipment and software utilized in connection with the Debtors' PBX telephone system at the location referred to as Addison I (the "Addison I Equipment" and together with the Addison II Equipment, the "Equipment").

16. The initial term of Schedule 5 was eighty-four months commencing on September 19, 1996. Upon the expiration of the initial term of Schedule 5, that schedule was renewed for a twelve-month period, and upon the expiration of that period, for successive monthly periods. The current rent under Schedule 5 is $4,700.75.

17. The initial term of Schedule 6 was seventy-six months commencing on December 31, 1996. Upon the expiration of the initial term of Schedule 5, that schedule was renewed for a twelve-month period, and upon the expiration of that period, for successive monthly periods. The current rent under Schedule 6 is $923.60.

18. The initial term of Schedule 7 was sixty-seven months commencing on September 2, 1997. Upon the expiration of the initial term of Schedule 7, that schedule

was renewed for a 120-day period, and upon the expiration of that period, for successive monthly periods. The current rent under Schedule 7 is $854.90.

19. The Court has authorized the Debtors to sell Addison I and II. Under the sale, which the Debtors contemplate closing on or before March 31, 2005, the Debtors will leaseback Addison I through approximately May 31, 2005 and Addison II for a term not to exceed three years. However, the Debtors will no longer need the Addison I Equipment effective on or about May 31, 2005 and the Addison II Equipment effective immediately.[4]

RELIEF REQUESTED

20. Pursuant to Bankruptcy Code § 365, the Debtors seek authority to reject the Agreements. As each of the schedules to the Master Lease are severable, the Debtors do not seek authority to assume or reject the schedules, other than the Agreements, at this time. *See Stewart Title Guaranty Co. v. Old Republic Nat'l Title Insur. Co.*, 83 F.3d 735, 741 (5th Cir. 1996).

21. Bankruptcy Code § 365 provides that the Debtors, "subject to the Court's approval, may assume or reject any executory contract and unexpired lease of the debtor." 11 U.S.C. § 365(a). A debtor operating its business pursuant to Bankruptcy Code §§ 1107 and 1108 must use reasonable judgment in ordinary business matters in its determination of whether to reject executory contracts and unexpired leases.

22. Bankruptcy Code § 365 does not provide a standard for determining when a debtor's rejection of an executory contract or unexpired lease is appropriate. *In re*

[4] The date on which the Debtors contemplate rejecting the Schedule 5, Schedule 6, and Schedule 7 is only an estimate and shall not be binding.

Monarch Tool & Manufacturing Co., 114 B.R. 134 (Bankr. S.D. Ohio 1990). However, most courts acknowledge that the business judgment standard should be applied to determine "whether to authorize the rejection of executory contracts and unexpired leases." *In re Federated Department Stores, Inc.*, 131 B.R. 808, 811 (Bankr. S.D. Ohio 1991) (citing, *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 523 (1984) and *Group of Investors v. Chicago, Milwaukee, St. Paul & Pacific Railroad Co.*, 318 U.S. 523 (1943)). As one court stated:

> [A] bankruptcy court . . . need determine only . . . whether disaffirmance would be advantageous to the debtor. The burden or hardship which rejection would impose on other parties to such a contract *is not* a factor to be weighed by the bankruptcy court in ruling upon the debtor's application.

Borman's, Inc. v. Allied Supermarkets, Inc., 706 F.2d 187, 189 (6th Cir.) (dicta), *cert. denied,* 464 U.S. 908 (1983) (emphasis added). Therefore, the Debtors may reject any executory contract or unexpired lease provided that they determine, in their business judgment, that rejection would be advantageous to them.

23. The Debtors have determined that, with respect to the Addison II Equipment, the goods provided under Schedule 1 currently are not necessary to their operations or to effect successful reorganizations of their businesses, and with respect to the Addison I Equipment, the goods provided under Schedule 5, Schedule 6, and Schedule 7 will not be necessary to their operations or to effect successful reorganizations of their businesses after approximately May 31, 2005. The Debtors' failure to reject the Agreements could result in the incurrence of unnecessary expense.

24. The Debtors request that the Court authorize the rejection of (i) Schedule 1 effective as of the date of the filing of this Motion and (ii) Schedule 5, Schedule 6, and

Schedule 7 effective as of ten days after the date on which the Debtors send a letter to Verizon informing it of the rejection of any of those schedules.

PRAYER

The Debtors respectfully request that the Court enter an Order authorizing the rejection of (i) Schedule 1 effective as of the date of the filing of this Motion and (ii) Schedule 5, Schedule 6, and Schedule 7 effective as of ten days after the date on which the Debtors send a letter to Verizon informing it of the rejection of any of those schedules. The Debtors also request such other and further relief to which they may be justly entitled.

Dated: March 21, 2005

Respectfully submitted,

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By: *_/s/ Richard H. London_*
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ATTORNEYS FOR THE DEBTORS

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CERTIFICATE OF SERVICE

This is to certify that on March 21, 2005, a copy of the foregoing document was served by the Electronic Case Filing System for the United States Bankruptcy Court for the Northern District of Texas. A separate certificate of service shall be filed with respect to those parties on the Clerk's list who do not receive electronic e-mail service and Verizon, whose notice address is 201 N. Franklin St., Suite 3300, Tampa, Florida, 33602.

/s/ Richard H. London
One of Counsel