Darryl S. Laddin (Georgia Bar No. 460793)
Heath J. Vicente (Georgia Bar No. 728289)
ARNALL GOLDEN GREGORY LLP
171 17th Street, Suite 2100
Atlanta, Georgia 30363-1031
Telephone: (404) 873-8500
Facsimile: (404) 873-8621

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

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
(DALLAS DIVISION)

In re:	)	Chapter 11
	)	
VARTEC TELECOM, INC., et al.,	)	Case No. 04-81694-saf11
	)	
Debtors.	)	Jointly Administered
	)	

EMERGENCY MOTION OF THE OPERATING TELEPHONE COMPANY SUBSIDIARIES OF VERIZON COMMUNICATIONS INC. FOR AN ORDER GRANTING ADEQUATE PROTECTION OR, ALTERNATIVELY, FOR ADEQUATE ASSURANCE OF PAYMENT

The operating telephone company subsidiaries of Verizon Communications Inc. (such subsidiaries, collectively, "Verizon")[1] hereby move this Court for entry of an order granting Verizon adequate protection pursuant to 11 U.S.C. § 363(e) or, alternatively, adequate assurance of payment pursuant to 11 U.S.C. § 366. In support thereof, Verizon respectfully represents as follows:

[1] The operating telephone company subsidiaries of Verizon Communications Inc. are Verizon North Inc., Contel of the South, Inc., Verizon South Inc., Verizon Northwest Inc., GTE Arkansas Inc. d/b/a Verizon Arkansas, GTE Midwest Incorporated d/b/a Verizon Midwest, GTE Southwest Inc. d/b/a Verizon Southwest, Verizon California Inc., Verizon Delaware Inc., Verizon Florida Inc., Verizon Hawaii Inc., Verizon Maryland Inc., Verizon New England Inc., Verizon New Jersey Inc., Verizon New York Inc., Verizon Pennsylvania Inc., Verizon Virginia Inc., Verizon Washington, DC Inc., and Verizon West Virginia Inc.

BACKGROUND

I. Procedural Background

1. On November 1, 2004 (the "Petition Date"), VarTec Telecom, Inc. and sixteen of its direct and indirect domestic subsidiaries (collectively, the "Debtors") each filed voluntary petitions for relief under chapter 11 of title 11 of the United States Code (the "Bankruptcy Code"). Upon information and belief, the Debtors continue to operate their businesses and manage their property as debtors-in-possession pursuant to sections 1107(a) and 1108 of the Bankruptcy Code.

II. Regulatory and Contract Status of Verizon and the Debtors

2. Before passage of the Telecommunications Act of 1996 (the "Telecom Act"), 47 U.S.C. § 251, et seq., local telephone service around the country was generally provided by ILECs directly to end-user customers through exclusive state-granted franchises. See AT&T Corp. v. Iowa Utils. Bd., 525 U.S. 366, 371 (1999). In 1996, Congress enacted the Telecom Act with an intent to "promote competition and reduce regulation in order to secure lower prices and higher quality services for American telecommunications consumers and encourage the rapid deployment of new telecommunications technologies." Pub.L. No. 104-104, 110 Stat. 56 (1996). Consistent with this purpose, the Telecom Act contains mechanisms designed to open the local telephone service markets to competition. Southwestern Bell Telephone Co. v. Brooks Fiber Communications, Inc., 235 F.3d 493, 495 (10th Cir. 2000).

3. In order to facilitate market entry by CLECs, the Telecom Act imposes a host of duties on ILECs, such as Verizon. See 47 U.S.C. § 251. Foremost among these duties is the duty to interconnect ILEC networks with CLEC networks. 47 U.S.C. § 251(c)(2). Interconnection ensures that consumers who subscribe to one local telephone service can receive calls from, and place calls to, those who subscribe to a different local service. 47 U.S.C. § 251(c)(2)(A).

4. Prior to the Petition Date, Verizon, in its capacity as an ILEC, entered into various interconnection agreements (the "Agreements") with the Debtors pursuant to which the Debtors obtain the right to use Verizon's telecommunications network, including circuits, facilities and equipment, in 31 states.[2]

5. The interconnection agreements between the Debtors and Verizon establish the terms, conditions and pricing under which Verizon will provide the Debtors with access to Verizon's network and under which the Debtors resell Verizon's local telephone service for the benefit of the Debtors' end user customers. The FCC and the applicable state agencies that regulate public utilities have established rules and regulations governing the terms, conditions, and prices required to be made available under interconnection agreements.

III. The Debtors' Payment and Service Relationship with Verizon

6. The Debtors had a repeated history of late or nonpayments to Verizon, which put them in default under their interconnection agreements and gave Verizon the right to terminate their services, upon specific notice and cure periods as required in various states. Most recently, Verizon issued default notifications on September 22, 2004 for over $4.4M of past due charges and September 28, 2004 for an additional $1.9M of past due charges. In the default notification dated September 28, 2004, Verizon also additionally requested adequate assurance of payment through a deposit or letter of credit equal to two months of the Debtors' average monthly billing to mitigate the risk of future payment defaults. Although the Debtors cured the aforementioned payment default, they did not provide the requested adequate assurance.

7. While Verizon has not yet completed its analysis of all of the Debtors' accounts, the Debtors' own records indicate that the Debtors owe Verizon over $17.4 million for

[2] Verizon and the Debtors are also parties to a Billing Services Agreement, pursuant to which Verizon purchases the accounts receivable of the Debtors. The Billing Services Agreement, which is not subject to the same utility regulations as the Interconnection Agreements, is not the subject of this Motion.

prepetition services. (See List of Creditors Holding 50 Largest Unsecured Claims.) Further, it is Verizon's understanding that initial estimates by the Debtors show that the Debtors incur charges to Verizon in the amount of at least $6.4 million per month.

8. The Debtors, meanwhile, have pledged all of their assets to their lender, the Rural Telephone Finance Cooperative (the "RTFC"), to secure what they acknowledge is an outstanding obligation of over $200 million. (See Second Interim Order Authorizing Post-Petition Financing (the "DIP Financing Order"), pp. 4-5, ¶ C(iv).) The Debtors further have acknowledged that, in the absence of DIP financing, they could not continue to operate their business. (Id., p. 6, ¶ D.) The RTFC, however, has the right to terminate the DIP financing and the Debtors' use of cash collateral without further Court order in the event of a default under the DIP Credit Agreement, on only five days' notice to the Debtors, Creditors' Committee and the U.S. Trustee (and without any notice to Verizon or any other individual creditor). (Id., p. 10, ¶4.) Recognizing the risk of non-payment of administrative expenses, professionals retained by the Debtors included in the DIP Financing Order a carve-out under the DIP facility for professional fees in the amount of $1.5 million plus budgeted fees in the event of written notice of default sent by RTFC.

9. The Debtors continue to use Verizon's network on a postpetition basis, thereby incurring substantial debts owing to Verizon. In order for the Debtor to continue to use Verizon's network, and to protect Verizon's interests for the essential postpetition services and facilities it provides, Verizon submits that it is entitled to adequate protection under section 363(e) of the Bankruptcy Code. Alternatively, Verizon submits that it is entitled to adequate assurance of payment under section 366 of the Bankruptcy Code.

ARGUMENT AND CITATION TO AUTHORITY

I. Verizon Is Entitled To Adequate Protection

10. Section 363(e) of the Bankruptcy Code prohibits the Debtors from using Verizon's telecommunications network, including circuits, facilities and equipment, without adequately protecting Verizon's interest. Section 363(e) provides as follows:

> Notwithstanding any other provision of this section, at any time, on request of an entity that has an interest in property used, sold, or leased, or proposed to be used, sold, or leased, by the trustee, the court, with or without a hearing, shall prohibit or condition such use, sale, or lease as is necessary to provide adequate protection of such interest. This subsection also applies to property that is subject to any unexpired lease of personal property (to the exclusion of such property being subject to an order to grant relief from the stay under section 362).

11 U.S.C. § 363(e). The Bankruptcy Code does not define "adequate protection." Section 361 of the Bankruptcy Code does, however, provide a non-exhaustive list of examples of adequate protection.

11. As adequate protection of its interests in the Debtors' cases, Verizon requests that the Court require the Debtors to provide Verizon with the following: (i) an immediate deposit in an amount equal to the Debtors' average monthly billing from Verizon for thirty days, (ii) an immediate payment for the postpetition services already provided to the Debtors by Verizon, and (iii) an immediate initial prepayment and then prepayment every 15 days thereafter, by wire-transfer of a sum equal to one-half (½) of the Debtors' average monthly billing from Verizon (so that, in a 30-day cycle, prepayments are made on the 1st and 15th days of such 30-day period).

II. Alternatively, Verizon Is Also Entitled To Adequate Assurance Of Payment

12. Verizon is also entitled to the same protections as described in paragraph 11 above as adequate assurance of payment under Section 366.

A. Section 366 is Applicable

13. Section 366 of the Bankruptcy Code entitles utilities to a "deposit or other security" as adequate assurance of payment. Specifically, Section 366 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 a request of a party in interest and after notice and 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.

14. Section 366, however, does not define the term "utility." Among the several definitions of "utility" offered by Black's Law Dictionary is the following: "a business enterprise that performs essential public service that is subject to government regulation." Black's Law Dictionary at 1544 (7th ed. 1999). The term "public utility" is defined as "a company that provides necessary services to the public, such as telephone, electricity and water." Id. Thus, Verizon is clearly a "utility" within the ordinary meaning of that term, because it provides telephone service to the public and is subject to regulation by the federal government and state public utility commissions in each state in which Verizon provides telecommunications service.

15. The legislative history of Section 366 also sheds some light on what Congress meant by "utility." Congress wrote that the section was intended "to cover utilities that have some special position with respect to the debtor, such as an electric company, gas supplier, or

telephone company that is a monopoly in the area so that the debtor cannot easily obtain comparable service from another utility." House Report No. 95-595, 95th Cong., 1st Sess, p. 350 (1977), U.S.Code Cong. & Admin.News, 1978, pp. 5787, 6306. The relationship between the Debtors and Verizon demonstrates that Verizon holds a special position with regard to the Debtors because, among other reasons, the Debtors cannot "easily obtain comparable services from another utility." Id.

16. Courts also have defined the scope of "utilities" covered by Section 366 expansively, including many entities not falling within the traditional definition of a utility. See e.g., In re Good Time Charlie's Ltd., 25 B.R. 226, 227 (Bankr. E.D. Pa. 1982) (finding a commercial landlord that supplied tenant debtor with electricity from local power company to be a utility under Section 366); In re Hobbs, 20 B.R. 488, 489 (Bankr. E.D. Pa. 1982) (condominium association deemed a utility under Section 366). A monopoly is not required for an entity to constitute a "utility" under Section 366. See In re Agrifos Fertilizer L.P., 2002 WL 32054779, *7 (Bankr. S.D. Tex. 2002) (holding that the determination of whether an entity is a "utility" under Section 366 does not turn on whether it is a monopoly); In re One Stop Realtour Place, Inc., 268 B.R. 430 (Bankr. E.D. Pa. 2001) (finding that a non-monopoly telephone exchange carrier that was regulated by the FCC and which provided necessary service to the debtor that could not easily be replaced was a "utility" for the purposes of Section 366).

17. Moreover, courts often apply Section 366 to telecommunications providers. See, e.g., In re Adelphia Business Solutions, Inc., 280 B.R. 63 (Bankr. S.D.N.Y. 2002) (applying Section 366 to ILECs including Verizon); In re One Stop Realtour Place, Inc., 268 B.R. 430 (Bankr. E.D. Pa. 2001) (telephone exchange carrier was a "utility" for the purposes of Section 366); In re Tel-Central Communication, Inc., 212 B.R. 342 (Bankr. W.D. Mo. 1997) (court

noting that it entered preliminary order finding that a telecommunications service provider was a "utility" under Section 366 where such entity provided services to a reseller); In re Sun-Tel Communications, Inc., 39 B.R. 10, 10-11 (Banrk. S.D. Fla. 1984) (local exchange carrier providing services to reseller was a "utility" under Section 366); In re Roberts, 29 B.R. 808 (E.D. Pa. 1983) (applying Section 366 to provider of residential telephone service).

18. Indeed, CLECs and other debtors in the telecommunications industry that obtain telecommunications services from Verizon repeatedly have asserted that Verizon is a "utility" within the meaning of Section 366, in part, no doubt, because they wished to continue receiving such services from Verizon without interruption. For example, debtors in the following cases, among many others, have filed motions recognizing that Verizon is a "utility" for purposes of Section 366: In re Coserv, LLC, Chapter 11 Case No. 01-48684, United States Bankruptcy Court, Northern District of Texas; In re Allegiance Telecom, Inc., Chapter 11 Case No. 03-13057, United States Bankruptcy Court, Southern District of New York; In re Worldcom, Inc., Chapter 11 Case No. 02-13533, United States Bankruptcy Court, Southern District of New York; In re Focal Communications Corporation, Chapter 11 Case No. 02-13709, United States Bankruptcy Court, District of Delaware; In re Winstar Communications, Inc., Chapter 11 Case No. 01-1430, United States Bankruptcy Court, District of Delaware; and In re Vitts Networks, Inc, Chapter 11 Case No. 01-0372, United States Bankruptcy Court, District of Delaware.

19. For the reasons set forth above, Verizon respectfully submits that it is a "utility" for purposes of Section 366 and is entitled to adequate assurance of payment from the Debtors for the postpetition use of Verizon's services and facilities.

B. Verizon is Entitled to Meaningful Adequate Assurance of Payment from the Debtors

1. The Debtors Bear the Burden of Proof as to Adequate Assurance Under Section 366.

20. As an initial matter, the Debtors bear the burden of proof on adequate assurance issues. In re Stagecoach Enterprises, Inc., 1 B.R. 732, 734 (Bankr. M.D. Fla. 1979) ("At a Section 366 hearing, the debtor, as the petitioning party, bears the burden of proof."). Accordingly, the Debtors must demonstrate that any protections they propose would, in fact, adequately assure Verizon of payment for postpetition services.

2. The Adequate Assurance of Payment Necessary in this Case.

21. Adequate assurance of payment must be sufficient to protect a utility from an unreasonable risk of nonpayment for postpetition services. See In re Heard, 84 B.R. 454 (Bankr. W.D. Tex 1987). What constitutes adequate assurance of payment "depends upon the facts and circumstances of each case, keeping in mind the intent of Congress to protect the utility company while preventing discrimination against the debtor." In re Keydata Corp., 12 B.R. 156, 158 (1st Cir. B.A.P. 1981). An administrative expense claim, and the hope of payment thereon, does not constitute "a deposit or other security" within the meaning of Section 366(b). In re Best Products Co., 203 B.R. 51, 54 (Bankr. E.D. Va. 1996) (holding that "adequate assurance under § 366 requires more than administrative priority").

22. In determining the amount of a deposit necessary for adequate assurance of payment, courts "have considered the length of time necessary for the utility to effect termination once one billing cycle is missed." Begley v. Philadelphia Elec. Co., 760 F. 2d 46, 49 (3d Cir. 1985). Other factors that courts take into consideration when determining the sufficiency of adequate assurance include "the debtor's payment history, the debtor's net worth, and the debtor's present and future ability to pay post-petition obligations." See In re 499 W. Warren

Street Associates Ltd. Partnership, 138 B.R. 363, 366 (Bankr. N.D.N.Y. 1991).

23. The Fifth Circuit has recognized that payment of a deposit is a proper means of providing a utility with adequate assurance of payment. Matter of Delta Towers, Ltd., 924 F. 2d 74 (5th Cir. 1991) ("Section 366 provides a utility company the opportunity to obtain protection in the form of a security deposit."). Other courts agree. For example, in In re Hanratty, 907 F.2d 1418 (3d Cir. 1990), the debtors sought to require an electric utility company to provide utility service without the payment of a security deposit. The court found that "[u]nder sub-section (b) [of Section 366], a utility is expressly authorized to request a debtor to furnish adequate assurance of payment in the form of a security deposit and may discontinue service if it is not provided within 20 days after the order for relief." Id. at 1423. The court added that "[w]e could only reach the result urged by the debtors by engrafting a court-created exception on 11 U.S.C. § 366 which would not further the purpose of that section. This we will not do." Id. at 1424. See also In re Northwest Recreational Activities, Inc., 8 B.R. 7 (Bankr. N.D. Ga. 1980) (deposit required for continued supply of water); In re Smith, Richardson & Convoy, Inc., 50 B.R. 5 (Bankr. S.D. Fla. 1985) (deposit required for continued supply of electricity); In re Stagecoach Enters., Inc., 1 B.R. 732 (Bankr. M.D. Fla. 1979) (deposit required for continued supply of gas service; court also specifically rejected concept of administrative expense claim serving as "adequate assurance" and stated that "[i]f the debtor is to be allowed to continue to operate its business, it should pay its utility bills on a current basis and should furnish adequate assurance of payment in the traditional forms of a cash deposit, a payment bond, or some similar device").

24. Other Bankruptcy and District Court judges, in unreported decisions, have reached the same conclusion – that Congress plainly and unambiguously required more than an administrative expense claim (which right already existed) by adopting the phrase "deposit or

other security" in Section 366(b) – even where a debtor has a good payment history, has substantial assets and significant postpetition financing (facts not present here).

25. In In re Armstrong World Industries, Wilmington, Delaware Case No. 00-4471 (JJF), Judge Farnan stated as follows:

> But I know out there in the world there is some dispute between utilities and debtors in the District of Delaware about 366, particularly (b). So I've been reading this. It's not that many words, but I read it a lot of times over the weekend, and it says – and that's what I'm focused on – "such utility may alter, refuse or discontinue service if neither the trustee" – and understand the Third Circuit, we now read statutes, particularly in the bankruptcy context, literally. It doesn't matter, anything, legislative history, all of that is out. You have to keep reading words to understand them – "within 20 days after the date of the order for relief, furnishing" here is the key words – "adequate assurance of payment."
>
> So you've got to do that in the form of a deposit or other security. But it doesn't say finding that the debtor's going to be okay to pay. It says "a deposit or other security" for service after such date.

In re Armstrong, March 7, 2001 Transcript at p. 42. Similarly, Judge Walsh has ruled:

> I do not believe that those cases which say that a good history, pre-petition history of utility payment and a strong liquidity position is assurance enough. I just don't think the language at 366(b) supports that, those cases. And I think that Congress has just very explicitly stated that a deposit or other security is required. That's the only basis for providing adequate assurance. It is not acknowledgement of a priority claim. It is not a handholding comfort level. I think the language is very clear that a deposit or other security is required. And I read 366(b) when it used the term security as security in the UCC sense of a collateral or a property interest. So for example, you could furnish the comfort by a letter of credit.

In re Weiner's Stores, Inc., Wilmington, Delaware Case No. 95-417 (PJW), June 9, 1995 Transcript at pp. 70-71.

26. In addition to the adequate assurance ordered in the industries involved in those cases described above, bankruptcy courts throughout the country have either ordered deposits and/or pre-payments, or approved stipulations requiring deposits and/or pre-payments, as adequate assurance under Section 366 in numerous bankruptcy cases in the telecommunications

industry. For example, bankruptcy courts have ordered or approved stipulations requiring deposits and/or pre-payments in the following cases, among others: See In re Winstar Communications, Inc., Chapter 11 Case No. 01-1430, United States Bankruptcy Court, District of Delaware**;** In re PSA, Inc., Chapter 11 Case No. 00-3570, United States Bankruptcy Court, District of Delaware; In re Net2000 Communications, Inc., Chapter 11 Case No. 01-11324, United States Bankruptcy Court, District of Delaware; In re Vitts Networks, Inc, Chapter 11 Case No. 01-0372, United States Bankruptcy Court, District of Delaware; In re Focal Communications, Inc., Chapter 11 Case No. 02-13709, United States Bankruptcy Court for the District of Delaware; In re Plan B Communications, Inc., Chapter 11 Case No. 01-11443, United States Bankruptcy Court for the Southern District of New York; In re RSL COM PrimeCall, Inc., Chapter 11 Case No. 01-11457 United States Bankruptcy Court for the Southern District of New York; In re Sun-Tel Communications, Inc., 39 B.R. at 10 (ordering debtor/reseller of long distance to provide deposit to Bell South after commenting that "[t]he debtor proposes to earn its way out of its current financial embarrassment … [t]he issue is whether Bell South may be compelled to finance that effort").

27. A thirty day deposit is appropriate here because thirty days is the minimum amount of notice required for the Debtors to give to their customers in order to discontinue providing telecommunications service. Before discontinuing service to their customers, the Debtors are required, among other things, to file an application with the Federal Communications Commission (the "FCC") requesting authority under section 214(a) of the Communications Act of 1934, 47 U.S.C. § 214(a), and section 63.71 of the FCC's rules, 47 C.F.R. § 63.71, to discontinue its domestic telecommunications services. Such an application is deemed filed on the date the FCC releases public notice of the filing. 47 C.F.R. § 63.71(c). Any

application to discontinue service filed by the Debtors will be automatically granted on the thirty-first day after the application is filed unless the FCC determines that public convenience and necessity require otherwise. Id. In recent cases, the FCC has acted to delay the service discontinuance beyond the thirty days prescribed under its regulations. See, e.g., In the Matter of e.spire Application to Discontinue Domestic and International Telecommunications Services, Order, Comp. Pol. File No. 592, 2002 WL1782176 (FCC) rel. Aug. 2, 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 the Matter of Telergy Network Services, Inc., et al., Section 63.71 Joint Application to Discontinue Domestic Telecommunications Services, 2002 FCC LEXIS 213, rel. Jan. 14, 2002 (extending the thirty day notice period for at least eight more days). State regulatory agencies also have their own discontinuance requirements, many of which are longer than the FCC requirements.[3] Consequently, if the Debtors run out of postpetition financing or even convert the case to one under Chapter 7, it is likely that the FCC or state regulatory agencies will nevertheless require the Debtors to continue providing services to their customers (and, in turn, require Verizon to continue providing service to the Debtors) until such thirty day or longer notice period expires. Therefore, as adequate assurance of payment, Verizon requests a deposit in the amount of thirty days' average usage to partially cover the service that will be provided to the Debtors prior to any allowed service termination.

28. Weekly prepayments are also necessary in this case to ensure that the Debtors, contrary to their prepetition conduct, will in fact pay for postpetition services provided by Verizon. If the Debtors were permitted to pay in arrears, given the billing cycle delay between

[3] For example, New York – a state in which the Debtors operate – generally requires 60 days advance notice to end users. See Mass Migration Guidelines, Revised and Orders by the New York Public Service Commission (Nov. 28, 2001).

the provision of service and the time at which such services are invoiced and become due, Verizon could be required to provide months of service before it can be determined whether the Debtors can, and will, in fact pay for such services. For many, if not most, services under current billing arrangements, Verizon bills for service in arrears, and payment is not due until thirty days after the date the bill is rendered. Thus, even if Verizon rendered all of its bills for services in a particular month by the end of that month, Verizon would not become aware of any payment default by the Debtors on those invoices until an entire additional month had expired – that is, Verizon would have rendered, minimally, two months of outstanding unpaid services. In light of the Debtors' extraordinarily poor payment history with Verizon, it should not be given the benefit of the doubt on this issue.

WHEREFORE, Verizon respectfully requests entry of an order granting the relief requested herein and such other and further relief as is just.

Dated: November 12, 2004

Respectfully submitted,

ARNALL GOLDEN GREGORY LLP

By: /s/Darryl S. Laddin_____

Darryl S. Laddin
Georgia Bar No. 460793
Heath J. Vicente
Georgia Bar No. 728289
171 17th Street, Suite 2100
Atlanta, Georgia 30363-1031
(404) 873-8500

Attorneys for Verizon

CERTIFICATE OF SERVICE

This is to certify that on this day I caused to be served a copy of the foregoing upon the persons listed below by facsimile transmission, and to all parties listed on the attached Service List via electronic mail and/or United States mail, first-class postage prepaid, on this 12th day of November, 2004:

Daniel C. Stewart
Vinson & Elkins
3700 Trammell Crow Center
2001 Ross Ave.
Dallas, TX 75201-2975
Fax: (214) 999-7761

Stephen A. Goodwin
Carrington, Coleman, Sloman & Blumenthal, LLP
200 Crescent Court, Suite 1500
Dallas, Texas 75201
Fax: (214) 855-1333

/s/Darryl S. Laddin_____
Darryl S. Laddin

VARTEC TELECOM, INC., et al.; Case No. 04-81694-SAF-11
MASTER SERVICE LIST
(Reads from Left to Right)
November 5, 2004
829352.1

Debtor:

Michael G. Hoffman
Chief Legal Officer
VarTec Telecom, Inc.
1600 Viceroy Drive
Dallas, Texas 75235

Rob Williams
VarTec Telecom, Inc.
1600 Viceroy Drive
Dallas, Texas 75235

David Walsh
VarTec Telecom, Inc.
1600 Viceroy Drive
Dallas, Texas 75235

Joe D'Angelo
VarTec Telecom, Inc.
1600 Viceroy Drive
Dallas, TX 75235

KJ Alzamora
VarTec Telecom, Inc.
1600 Viceroy Drive
Dallas, TX 75235

Debtors' Counsel:

Daniel C. Stewart
Vinson & Elkins LLP
2001 Ross Avenue
3700 Trammell Crow Center
Dallas, Texas 75201

William L. Wallander
Vinson & Elkins LLP
2001 Ross Avenue
3700 Trammell Crow Center
Dallas, Texas 75201

Craig W. Budner
Hughes & Luce L.L.P.
1717 Main Street
Suite 2800
Dallas, Texas 75201

Beth Bivans
Hughes & Luce L.L.P.
1717 Main Street
Suite 2800
Dallas, Texas 75201

Thomas Raxton
Hughes & Luce L.L.P.
1717 Main Street
Suite 2800
Dallas, Texas 75201

Governmental Agencies:

George McElreath
Office of the U.S. Trustee
1100 Commerce Street
Room 976
Dallas, Texas 75242

United States Attorney's Office
1100 Commerce Street
Third Floor
Dallas, Texas 75242

Internal Revenue Service
Special Procedures Branch
Mail Code 5020-DAL
1100 Commerce Street, Room 938
Dallas, Texas 75242

Kay D. Brock, Asst. Attorney General
Office of the Texas Attorney General
Bankruptcy and Collections Division
P.O. Box 12548
Austin, Texas 78711-2548

M. Jane Brady
Office of the Delaware Attorney General
Carvel State Office Bldg.
820 N. French Street
Wilmington, DE 19801

Jerry Kilgore
Office of the Virginia Attorney General
900 East Main Street
Richmond, VA 23219

Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Texas Workforce Commission
TEC Building – Bankruptcy
101 East 15th Street
Austin, TX 78778

Comptroller of Public Accounts
Revenue Accounting Division
Bankruptcy Section
PO Box 13528
Austin, TX 78711

Secured Lenders:

Roberta Aronson
Rural Telephone Finance Cooperative
2201 Cooperative Way
Herndon, VA 20171-3025

Rob Dyson
Rural Telephone Finance Cooperative
2201 Cooperative Way
Herndon, VA 20171-3025

Cindy Gugino
Rural Telephone Finance Cooperative
2201 Cooperative Way
Herndon, VA 20171-3025

Larry Zawalick
Rural Telephone Finance Cooperative
2201 Cooperative Way
Herndon, VA 20171-3025

Counsel for Secured Lenders:

Toby L. Gerber
Fulbright & Jaworski LLP
2200 Ross Avenue
Suite 2800
Dallas, Texas 75201

John N. Schwartz
Fulbright & Jaworski LLP
2200 Ross Avenue
Suite 2800
Dallas, Texas 75201

Ryan A. Manns
Fulbright & Jaworski LLP
2200 Ross Avenue
Suite 2800
Dallas, Texas 75201

William R. Greendyke
Fulbright & Jaworski LLP
1301 McKinney, Suite 5100
Houston, TX 77010-3095

Exhibit A

Fifty Largest Unsecured Creditors (Consolidated):

Steve Smith
c/o Kolodey Thomas, Blackwood & Thomas
Attn: Tom Thomas
5910 N. Central Expressway
700 Premier Place
Dallas, TX 75206

MCI WorldCom/MFS
Attn: Gina Forgione
Mail Drop 5.3-518
6929 N Lakewood Ave.
Tulsa, OK 74117

Qwest
Attn: Megan Cristensen
250 East Bell Plaza, Room 609
Salt Lake City, UT 84111

Southwestern Bell
Attn: Leigh Ann Young
529 South 7th Street Floor 2B
Springfield, IL

GTE
Attn: Missy Dean
2701 South Johnson
San Angelo, TX 76904

Pacific Bell
Attn: Leigh Ann Young
529 South 7th Street, Floor 2B
Springfield, IL 62721

Century Tel
Attn: Judy Cooper
100 Centurytel Dr.
Monroe, LA 71211

ZNET Communications
Attn: Joseph M. Zeno
19349 N. 12th Street
Covington, :LA 70433

Teleglobe, Inc.
Attn: Chief Executive Officer
11495 Commerce Park Drive
Reston, VA 20191

Verizon
Attn: Lynn Bowes
3632 Roxboro Road
Durham, NC 27704

Regions Bank
Attn: Matthew Spencer
400 West Capital
Little Rock, AR 72201

Bell South
Attn: Katrina Whitely
1 Chase Corporate Center Suite 300
Birmingham, AL 35244

AT&T
Attn: Steve Kouns
1001 E. Fayette Street
Baltimore, MD 21202

Bell Atlantic
Attn: Lynn Bowes
3632 Roxboro Road
Durham, NC 27704

US West
Attn: Barbara Vallejo
250 East Bell Plaza, Rm 609
Salt Lake City, UT 84111

Unipoint Holdings
Attn: Asmita Phadke
6500 River Place Blvd,
Bldg 2, Ste 200
Austin, TX 78730

Ameritech
Attn: Leigh Ann Young
529 South 7th Street, Floor 2B
Springfield, IL 62721

RNI Communications Corp. dba Rubicon Technologies
Attn: Robert D. Smith
75 Broad Street, 2nd Floor, Suite 210
New York, NY 10004

Alltel
Attn: Jeff Wakelyn
One Allied Drive
Little Rock, AR 72202

Visionquest Marketing Services, Inc.
Attn: Chad Jenkins
PO Box 5304
Norman, OK 73070-5304

NTS Communications
Attn: Barbara Andrews, President
5307 West Loop 589
Lubbock, TX 79414

Specialty Outsourcing Solution, Ltd.
Attn: Jay Lankford
PO Box 23407
Waco, TX 76702-3407

Oracle Corp.
Attn: Tiffany Lee
500 Oracle Parkway
Redwood Shores, CA 94065

Citizens Communications
Attn: Debbie Wolke
14450 Burnhaven Drive
Burnsville, MN 55306

Comdisco, Inc.
Attn:Michelle Motzkus
2312 Collection Center D
Chicago, IL 60693

Etelecare International
Attn: Peter Mikhalev
602 E Huntington Dr. Suit H
Monrovia, CA 91016

LM Data of Texas
Attn: Richard Frank
234 Venable Lane
Monroe, LA 71203

Sprint Canada
Attn: Jay Garcia
2235 Sheppard Avenue East
Atria II, Suite 600
Toronto, Ontario M2J5G1

Level 3 Communications
Attn: Peggy Hurley
1025 Eldorado Blvd.
Broomfield, CO 80021

Broadwing
Attn: Ernest Williams
1122 Capital of Texas Highway South
Austin, TX 78746

Sybase, Inc.
C/O Bank of America
Attn: Remittance Processing
6000 Feldwood Rd.
College Park, GA 30349

Personix Houston
Attn: Eileen Westerfield
PO Box 173879
Denver, CO 80217-3879

Cyber City Teleservices, Ltd.
Attn: Gina Gopez
CCT Marketing LLC
401 Hackensack Ave.
Hackensack, NJ 07601

Wyndham Anatole
Attn: D. Bradley Kent
2201 Stemmons Freeway
Dallas, TX 75207

Center Operating Company, LP
Attn: P. Taggart
American Airlines Center
2500 Victory
Dallas, TX 75219

Palmetto
Attn: Accounts Payable
491 Lakeshore Parkway
Rockhill, SC 29730

Televista
Attn: Patricia Perry
19111 Dallas Parkway
Dallas, TX 75287

USHA Communications
111 SW 5th Ave. Suite 1700
Portland, OR 97204

Valor Communications
Attn: Lisa Smith
1401 Elm Street, 5th Floor
Dallas, TX 75202

Hewlett Packard
Attn: Financial Service Company
PO Box 402582
Atlanta, GA 30384-2582

Arnold Logistics, LLC
P O Box 42541
Philadelphia, PA 19101

Protel
Attn: Iiana Salazar Penagos
#81 Loma Del Sotelo
Mexico D.F. 11200

Brightpoint, Inc.
1615 Paysphere Circle
Chicago, IL 60674

Parties to Capital Leases:

SNET
Attn: Steve Totora
4 Hamilton Street, 2nd Floor
New Haven, CT 06511-6617

tekVizion PVS, Inc.
Attn: Teri Albers Griffin
2301 N. Greenville Ave., Suite 400
Richardson, TX 75082

IKANO
265 E. 100 St., Ste. 245
Salt Lake City, UT 84111

Illuminet SS-7
Attn: Kathy Lawrenz
7400 W. 129th St.
Overland Park, KS 66213

AFNI
Attn: Dept. 0478
PO Box 120478
Dallas, TX 75312-0478

Pacific Tel (Century)
Attn: Ken Crawford
100 Centurytel Dr.
Monroe, LA 71211

Delcan Holdings, Ltd.
Attn: Martin Pugh
5 Place de la Fusterie
CP 3033
Geneva, Switzerland

Bay4 Capital
311 North Bayshore Drive
Safety Harbor, FL 34695

Exhibit A

HP Financial Services
420 Mountain Avenue
PO Box 6
Murray Hill, NJ 07974

GE Capital
10 Riverview Drive
Danbury, CT 06810

Kronos Inc.
297 Billerica Rd.
Chelmsford, MA 01824

Parties Requesting Notice:

Darrin S. Laddin
Heath J. Vicente
Armall Golden Gregory LLP
171 17th Street, Suite 2100
Atlanta, GA 30363-1031

Rex D. Rainach
3622 Government Street
Baton Rouge, LA 70806-5720

John K. Paul
100 Century Park Drive
Monroe, LA 71203

Paul M. Rosenblatt, Esq.
Kilpatrick Stockton LLP
1100 Peachtree Street, NE, Suite 2800
Atlanta, GA 30309-4530

Reginald A. Greene
Bellsouth Corporation
1155 Peachtree Street – 18th Floor
Atlanta, GA 30309

J. Mark Chevallier; Steven H. Thomas;
David Woods
McGuire Craddock & Strother, PC
3550 Lincoln Plaza
500 N. Akard St.
Dallas, TX 75201

Elizabeth Weller
Linebarger Goggan Blair Sampson
2323 Bryan Street, Suite 1600
Dallas, TX 75201

Lisa A. Epps
Spencer Fane Britt & Browne, LLP
1000 Walnut Street, Suite 1400
Kansas City, MO 64105

Vincent D'Agostino
Lowenstein Sandler PC
65 Livingston Avenue
Roseland, NJ 07068

Marvin Mohney
120 Founders Square
900 Jackson Street
Dallas, TX 75202

Michael T. Benz
Chapman & Cutler LLP
111 W. Monroe St., 15th Floor
Chicago, IL 60603

Greg Donovan
Afni, Inc.
404 Brook Drive
Bloomington, IL 61701

Exhibit A

Mark D. Collins
Richards Layton & Finger, PA
One Rodney Square
PO Box 551
Wilmington, DE 19899

Linda Boyle
Time Warner Telecom, Inc.
10475 Park Meadows Drive, #400
Littleton, CO 80124

Kathy Morgan
Teleglobe Telecom Corporation
11495 Commerce Park Drive
Reston, VA 20191

Howard M. Levine
Sussman Shank LLP
1000 SW Broadway, Suite 1400
Portland, OR 97205-3089

C. Wade Cooper
Marvin E. Sprouse III
Jackson Walker LLP
100 Congress, Suite 1100
Austin, TX 78701

Patricia B. Tomasco
Brown McCarroll, LLP
111 Congress Avenue, Suite 1400
Austin, TX 78701

Stephen A. Youngman
Weil Gotshal & Manges, LLP
200 Crescent Court, Suite 300
Dallas, TX 75201-5950

James T. Grogan III
Weil Gotshal & Manges LLP
700 Louisiana, Suite 1600
Houston, TX 77002

Peter Franklin III
Locke Liddell & Sapp LLP
2200 Ross Avenue, Suite 2200
Dallas, TX 75201-6776

Kelly Franklin Bagnall
Brown McCarroll LLP
2000 Trammell Crow Center
2001 Ross Avenue
Dallas, TX 75201-2997

WilTel Communications, LLC
Attn: Kevin Ward, Attorney
One Technology Center, MD 15-l
100 S. Cincinnati
Tulsa, OK 74103

David L. Campbell; Claude D. Smith
Campbell & Cobbe, PC
900 Jackson Street
120 Founders Square
Dallas, TX 75202

Andrew Sherman
Sills Cummis Epstein & Gross PC
One Riverfront Plaza
Newark, NJ 07102-5400

David G. Aelvoet
Linebarger Goggan Blair & Sampson LLP
Travis Bldg., 711 Navarro, Suite 300
San Antonio, TX 78205

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Exhibit A