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**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-HDH-11
	§	
DEBTORS.	§	(Chapter 11)
	§	(Jointly Administered)
	§	
	§	Hearing Set for October 11, 2005 at
	§	1:30 p.m.

**DEBTORS' INITIAL RESPONSE TO OFFICIAL COMMITTEE OF
UNSECURED CREDITORS' OBJECTION TO MOTION TO
APPROVE ESTATE DEBTOR IN POSSESSION FINANCING**

TO THE HONORABLE HARLIN D. HALE, UNITED STATES BANKRUPTCY JUDGE:

The above-referenced debtors and debtors in possession (collectively, the "Debtors")¹ file this Initial Response to Official Committee of Unsecured Creditors' Objection to Motion to Approve Estate Debtor in Possession Financing (the "Response"), and in support would respectfully show the Court as follows:

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 Resources Services, Inc., VarTec Solutions, Inc., VarTec Telecom Holding Company, VarTec Telecom International Holding Company, and VarTec Telecom of Virginia, Inc.

PROCEDURAL AND FACTUAL BACKGROUND

1. On June 17, 2005, the Debtors filed their Motion for Authority to Sell Assets Free and Clear of All Liens, Claims, Rights, Interests, and Encumbrances and For Related Relief (Substantially All of the Debtors' Remaining Assets) [Docket No. 1399] (the "Sale Motion"), in which they requested, among other things, approval of the sale (the "Sale") of substantially all of their operating assets (the "Acquired Assets"). After an auction of the Acquired Assets, the Debtors identified Comtel Investments LLC (together with its assigns, "Comtel") as the successful bidder, and on July 29, 2005, the Court entered its Order (A) Approving the Sale Free and Clear of All Liens, Claims, Rights, Interests and Encumbrances to Comtel Investments LLC and (B) Granting Related Relief (Substantially All of the Debtors' Remaining Assets) [Docket No.1663] (the "Sale Order") in which it approved the Sale and the execution of the Asset Purchase Agreement dated July 25, 2005 by and among the Debtors and Comtel.

2. As contemplated by the parties, on September 29, 2005, the Debtors filed their Motion for Interim and Final Orders (i) Authorizing the Debtors to Obtain Post-Petition Financing on an Interim and Final Basis Secured by Senior Priming Liens, (ii) Scheduling a Final Hearing and Establishing Notice Requirements, and (iii) Granting Related Relief (Rural Telephone Finance Cooperative) [Docket No. 1919] (the "Motion")² in which they request approval of, among other things, the New RTFC DIP Financing to satisfy expenses associated with the administration of their Cases (the "Estate Expenses").

² Capitalized terms not defined herein shall have the meaning given to them in the Motion.

3. On October 10, 2005, the Official Committee of Unsecured Creditors (the “Official Committee”) filed their Objection [Docket No. 1966] (the “Objection”) to the Motion. On that same day, MCI Network Services, Inc. and MCI Communications Services, Inc. filed their Joinder [Docket No. 1968] in the Objection.

RESPONSE

The Estate Financing Is Necessary and in the Debtors’ Estates’ Best Interests

4. Since the Court’s entry of the Sale Order (more than seventy days ago), the Debtors have not had funds available to satisfy the Estate Expenses, including the fees and expenses of the various case professionals, and without the New RTFC DIP Financing, the Debtors will be unable to satisfy those expenses. No funds have been available to make holdback payments for the February through June period nor to make payments for the regular services after July 1, 2005.³ The Official Committee does not dispute that the Debtors need a source of funds to satisfy Estate Expenses. Rather, without advising the Debtors of alternative, tangible sources of funds to pay the Estate Expenses, the Official Committee objects to the security and priority to be granted to the RTFC on account of the New RTFC DIP Financing.

5. The Debtors extensively have negotiated the New RTFC DIP Financing Agreement, and they have been unable to obtain financing on more favorable terms than those set forth in that agreement. As they pled in the Motion, the Debtors have an immediate need for the New RTFC DIP Financing. Further, the RTFC has indicated

³ The Debtors reserved from the proceeds of the first closing of the Sale certain estimated fees and expenses of Vinson & Elkins L.L.P. (“V&E”) directly attributed thereto, and the Debtors have delivered that payment to V&E.

that it is willing to finance the payment of the Estate Expenses only on the terms set forth in the New RTFC DIP Financing Agreement.

The Need for the Estate Financing Has Been Discussed with the Official Committee prior to the Filing of the Sale Motion

6. The need for debtor in possession financing to satisfy Estate Expenses should not be a surprise to the Official Committee and any suggestion that it did not have advance notice of the proposed financing is disingenuous.

7. Prior to the filing of the Sale Motion, it became clear that the sale of the Acquired Assets would be structured such that the funds generated from the operation of the Debtors' businesses (after the Court's approval of the Sale) would be used to pay operating expenses and any surplus funds would remain in the Debtors' estates pending the final closing of the Sale. As a consequence of this "trapping" mechanism, the parties quickly determined that a separate financing facility would be necessary to satisfy Estate Expenses.

8. Since that time, the need for the debtor in possession financing was discussed at length on a number of occasions with the Rural Telephone Finance Cooperative (the "RTFC") and the Official Committee. In fact, the filing of the Motion was delayed on a few occasions as a result of the Official Committee's request for additional time. Upon information and belief, the Official Committee sought to utilize that additional time so that the Official Committee could explore a possible global resolution of claims asserted against the RTFC. Unfortunately, that resolution has not come to fruition.

**The Cases Have Benefited All Creditors, including
 Holders of General Unsecured Claims**

9. Citing the fact that the proceeds from various asset sales have been applied to prepetition obligations owing to the RTFC, the Official Committee alleges that the Cases have been “run solely for the benefit of the RTFC.” *Objection* at ¶ 6. This allegation is not true.

10. As an initial matter, the Official Committee neglects to acknowledge that, by the express language of the Court’s Orders approving various sales, each paydown of the obligations to the RTFC has been **provisional** and **subject to** the resolution of the Official Committee’s adversary proceeding against the RTFC; and therefore, any amounts paid to the RTFC are subject to possible disgorgement.

11. Given that the payments to the RTFC have been provisional, the Debtors’ efforts to maximize the value of their estates benefits all creditors. The Debtors have conducted a number of effective and successful auctions of various of their assets. Those auctions have generated significant proceeds and have maximized value. As a result of the sales processes, a number of executory contracts and unexpired leases have been or will be assumed and assigned to various purchasers, and the associated arrearages under those contracts and leases have been or will be cured or otherwise satisfied. Specifically, the proposed assumption and assignment (pending the final closing of the Sale) of various of the Debtors’ carrier agreements will result in the cure of prepetition arrearages valued in the tens of millions of dollars. Undoubtedly, those assumptions and assignments benefit the Debtors’ creditors, large and small alike.

12. Further, during the Cases, the Official Committee exhaustively has investigated claims and causes of action against third parties, including the RTFC. The

Official Committee cannot argue that those investigations have not benefited the Debtors' estates. The Official Committee has incurred professional fees relating to such investigations which have cost the Debtors' estates several hundreds of thousands – if not millions – of dollars. A large portion of these expenses were funded by the Debtors through its previous debtor in possession financing facility with the RTFC.

The Court Previously Has Determined the Surcharge Issue

13. The Official Committee's objection with respect to the waiver of the surcharge protection previously has been ruled upon by the Court, and it should not be revisited.

14. In their objection to the then-proposed debtor in possession financing facility, the Official Committee argued that it would be inappropriate for the surcharge protection pursuant to Bankruptcy Code § 506(c) to be waived. At the hearing on the initial DIP Financing, the Court considered that argument and ruled as follows:

First, with the 506(c) issue, the Court appreciates that it is on record as not favoring these kinds of waivers. But I do have to balance the circumstances of each case. It strikes the Court that this case represents an appropriate balance to take the waiver with the other conditions in the order. And the two primary considerations the Court is given there is you have a carve-out. And that carve-out will be used in effect to preserve assets and thereby the collateral. Typically you have a carve-out. So that in and of itself doesn't sway this. But, two, the swing consideration it seems to me is the agreement with the carriers. And when you have that kind of arrangement agreed to by the DIP lender with the carve-out you have circumstances here to permit a 506(c) waiver by the debtor.

Transcript of Hearing on January 12, 2005, page 73, lines 20-25; page 74, lines 1-8.

15. Consistent with its ruling, the Court's Final Order Authorizing Post-Petition Financing, Granting Senior Liens and Priority Administrative Expense Status, Authorizing Use of Cash Collateral and Modifying the Automatic Stay [Docket No. 789] (the "Final DIP Financing Order"), which was entered on January 12, 2005, provides,

“No cost or expense which is incurred by the Debtors in connection with or on account of the preservation or disposition of any Collateral or which otherwise could be chargeable to the Lender or the Collateral pursuant to Bankruptcy Code § 506(c) or otherwise, shall be chargeable to the Lender or the Collateral.” *Final DIP Financing Order* at ¶ 21.

16. No party in interest, including the Official Committee, appealed the Final DIP Financing Order; and therefore, it is the law of the case and that issue may not be re-argued at this time.

RESERVATION OF RIGHTS

17. The Debtors reserve their right to supplement or amend this Response at or prior to any interim or final hearing on the Motion and to raise additional arguments at such hearings.

PRAYER

The Debtors respectfully request that this Court enter an Order approving the relief requested in the Motion and granting them such other and further relief to which they may be justly entitled.

Dated: October 11, 2005.

Respectfully submitted,

VINSON & ELKINS L.L.P.

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CERTIFICATE OF SERVICE

This is to certify that on October 11, 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.

/s/ Richard H. London

One of Counsel