

B 104 (Rev. 2/92)		ADVERSARY PROCEEDING COVER SHEET (Instructions on reverse)		ADVERSARY PROCEEDING NUMBER (Court Use Only)	
PLAINTIFFS VarTec Telecom, Inc. Excel Telecommunications, Inc.			DEFENDANT Qwest Corporation		
ATTORNEYS (Firm Name, Address and Telephone No.) James J. Lee Holly J. Warrington Vinson & Elkins L.L.P. Trammell Crow Center 2001 Ross Avenue, Suite 3700 Dallas, TX 75201-2975 (214) 220-7700			ATTORNEYS (if known) Andrew H. Sherman Sills Cummis Epstein & Gross One Riverfront Plaza Newark, NJ 07102 (973) 643-6982		
PARTY (Check one box only) <input type="checkbox"/> 1 U.S. PLAINTIFF <input type="checkbox"/> 2 U.S. DEFENDANT <input checked="" type="checkbox"/> 3 U.S. NOT A PARTY					
CAUSE OF ACTION (WRITE A BRIEF STATEMENT OF CAUSE OF ACTION, INCLUDING ALL U.S. STATUTES INVOLVED) Complaint seeking (1) declaratory judgment under 28 U.S.C. §§2201 and 2202 and (2) turnover of property of the estate under 11 U.S.C. § 542, and (3) damages for violations of the automatic stay under 11 U.S.C. §§ 105 and 362.					
NATURE OF SUIT (Check the most appropriate box only.)					
<input checked="" type="checkbox"/> 454 To Recover Money or Property		<input type="checkbox"/> 455 To revoke an order of confirmation of a Chap. 11, Chap. 12 or Chap. 13 Plan		<input type="checkbox"/> 456 To obtain a declaratory judgment relating to any of foregoing causes of action	
<input type="checkbox"/> 435 To Determine Validity, Priority, or Extent of a Lien or Other Interest in Property		<input type="checkbox"/> 426 To determine the dischargeability of a debt 11 U.S.C. § 523		<input type="checkbox"/> 459 To determine a claim or cause of action removed to a bankruptcy court	
<input type="checkbox"/> 458 To Obtain approval for the sale of both the interest of the estate and of a co-owner in property.		<input type="checkbox"/> 434 To obtain an injunction or other equitable relief		<input type="checkbox"/> 498 Other (specify): Notice of Removal	
<input type="checkbox"/> 424 To Object or Revoke a discharge 11 U.S.C. § 727		<input type="checkbox"/> 457 To subordinate any allowed claim or interest except where such subordination is provided in a plan.		<input type="checkbox"/> 5 Transferred from Another Bankruptcy Court	
ORIGIN OF PROCEEDINGS (Check one box only)		<input checked="" type="checkbox"/> 1 Original Proceeding		<input type="checkbox"/> 2 Removed Proceeding	
		<input type="checkbox"/> 4 Reinstated or Reopened		<input type="checkbox"/> CHECK IF THIS IS A CLASS ACTION UNDER F.R.C.P. 23	
DEMAND	NEAREST THOUSAND: \$1,380	OTHER RELIEF SOUGHT:		<input type="checkbox"/> JURY DEMAND	
BANKRUPTCY CASE IN WHICH THIS ADVERSARY PROCEEDING ARISES					
NAME OF DEBTOR: VarTec Telecom, Inc., <i>et al.</i>			BANKRUPTCY CASE NO. 04-81694-HDH-11 (Jointly Administered)		
DISTRICT IN WHICH CASE IS PENDING: U.S. Bankruptcy Court Northern District of Texas		DIVISIONAL OFFICE Dallas Division		NAME OF JUDGE Honorable Harlin D. Hale	
RELATED ADVERSARY PROCEEDING (IF ANY)					
PLAINTIFF		DEFENDANT		ADVERSARY PROCEEDING NO.	
DISTRICT		DIVISIONAL OFFICE		NAME OF JUDGE	
FILING FEE (Check one box only.) <input checked="" type="checkbox"/> FEE ATTACHED <input type="checkbox"/> FEE NOT REQUIRED <input type="checkbox"/> FEE IS DEFERRED					
DATE 12/8/05	PRINT NAME James J. Lee		SIGNATURE OF ATTORNEY (OR PLAINTIFF) <i>/s/ James J. Lee</i>		

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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-HDH-11
	§	
Debtors.	§	(Chapter 11)
	§	(Jointly Administered)
	§	
	§	
	§	
	§	
<hr/>		
VARTEC TELECOM, INC. and	§	
EXCEL TELECOMMUNICATIONS,	§	
INC.,	§	
	§	
Plaintiffs,	§	Adv. Proc. No. _____
	§	
v.	§	
	§	
QWEST CORPORATION	§	
	§	
Defendant.	§	

**COMPLAINT FOR TURNOVER OF PROPERTY OF THE ESTATE
 AND DECLARATORY JUDGEMENT REGARDING
QWEST'S INABILITY TO SETOFF**

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

VarTec Telecom, Inc. ("VarTec") and Excel Telecommunications, Inc. ("Excel" and with VarTec the "Contracting Debtors") file this Complaint for Turnover of Property

of the Estate and Declaratory Judgment Regarding Inability to Setoff (the “Complaint”) against Qwest Corporation (“Qwest”) and in support would show as follows:

PARTIES

1. Qwest is a Colorado corporation.
2. Qwest can be served by first class mail postage prepaid to its Chief Executive Officer, Richard C. Notebaert, located at Qwest’s corporate headquarters, 1801 California Street, Denver, Colorado 80202.

JURISDICTION AND PROCEDURAL BACKGROUND

3. The Court has jurisdiction over this Adversary Proceeding pursuant to 28 U.S.C. §§ 1334 and 157 because this is a proceeding that arises under title 11 of the United States Code (the “Bankruptcy Code”). This Adversary Proceeding is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(A), (E) and (O) because it deals with the administration of the Debtors’ estates and turnover of property of the estates.

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

5. On November 1, 2004 (the “Petition Date”), the debtors in the above-references jointly administered cases, including the Contracting Debtors, (the “Debtors”) each filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code (collectively, the “Cases”).

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

7. The Debtors’ Cases are jointly administered under the Case styled *In re VarTec Telecom, Inc.*; Case No. 04-81694-HDH-11.

STATEMENT OF FACTS

VarTec and Its Business

8. As of the Petition Date, the Debtors were among the largest privately held companies providing telecommunications services in North America. 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] in which it authorized the sale of substantially all of the Debtors' remaining assets to Comtel Investments LLC ("Comtel") under that certain Asset Purchase Agreement dated July 25, 2005 by and among the Debtors and Comtel (the "APA").

The Industry

9. Prior to 1996, local telecommunications services were provided exclusively by traditional, monopoly providers, or incumbent local exchange carriers (the "ILECs"). Pursuant to the Telecommunications Act of 1996, which was enacted to promote competition in the local telecommunications industry, ILECs such as Qwest were required to provide competitive local exchange carriers (the "CLECs"), such as the Debtors, access to their networks to allow these competitors to offer local telecommunications services. The terms, conditions, and prices charged by ILECs to CLECs are provided in agreements – referenced as "interconnection agreements" – governed by rules and regulations promulgated by the Federal Communications Commission and various state agencies or public utility commissions. Additionally, the ILECs often handle the billing and collection functions on behalf of the CLECs with regard to end-users who are their mutual customers and for whom the particular ILEC

provides local phone service. The terms of these arrangements are customarily reflected in so-called “billing and collection agreements.”

Relationship With Qwest

10. On September 1, 2002, Qwest and VarTec entered into the *Provision of Billing and Collection Services for Message Telephone Service (MTS) and 900 Billing*, together with all exhibits, appendixes and related documents (the “Qwest Billing Agreement”).

11. Excel became governed by the Qwest Billing Agreement starting November 1, 2002, due to the fact that Excel’s prior billing and collections agreement with Qwest expired on October 31, 2002.

12. Under the Qwest Billing Agreement, Qwest is required to bill the Contracting Debtors’ end-user customers and collect funds from such end-user customers on behalf of, and for the benefit of, the respective Contracting Debtor. Qwest receives a service charge for performing this task. The Qwest Billing Agreement expressly provides that all risk of loss with respect to amounts billed to end-user customers remains with the Contracting Debtors, as Qwest has reimbursement rights to the extent that collections from end-user customers are less than the amounts paid by Qwest to Excel or VarTec, as applicable.

Post-Petition Events

13. On December 2, 2004, the Court approved the Stipulation and Consent Order by and Among Certain Carriers and the Debtors Regarding Adequate Assurance/Adequate Protection of Future Payments [Docket No. 451] (the “Carrier Stipulation”). The Carrier Stipulation was executed by Qwest and accordingly became

binding upon Qwest, the Debtors, and their respective successors and assigns. The Carrier Stipulation defines specific rights and obligations, as well as technical procedures that govern such rights and obligations, between and among the parties.

14. On January 10, 2005, Qwest sent a notice to the Debtors (the "Setoff Notice") claiming that, under the Carrier Stipulation, it has the right to setoff amounts Qwest owes to each Contracting Debtor under the Qwest Billing Agreement against amounts that the Debtors allegedly owe Qwest (i) under the Qwest Billing Agreement and (ii) other unrelated service agreements.

Actionable Conduct by Qwest

15. Qwest has wrongfully withheld \$1,379,577.55 of prepetition funds belonging to the Contracting Debtors (the "Held Funds"). The Held Funds consist of (a) \$573,723.99 of prepetition payments (net of Qwest's service charge) which Qwest has collected from end-users and owes to the Contracting Debtors under the Qwest Billing Agreement and (b) \$805,953.56 in a bad debt reserve fund unilaterally withheld by Qwest. Qwest has no valid basis for claiming ownership or possession of these funds. Consequently, \$1,379,577.55 of the Contracting Debtors' property is being wrongfully retained and should be immediately turned over to the Contracting Debtors' estates by Qwest.

16. Under the Qwest Billing Agreement, Qwest is permitted to deduct a service charge from the funds Qwest collects from the Contracting Debtors' end-user customers. See Qwest Billing Agreement, § 14. The funds in excess of the service fee are payable to the respective Contracting Debtor. The Held Funds consist of \$573,723.99 that fall into this category.

17. The Qwest Billing Agreement expired by its own terms prior to the Petition Date on August 31, 2004. See Qwest Billing Agreement, § 16.A. Under the Qwest Billing Agreement, Qwest had the ability to retain a bad debt reserve for up to 12 months after its termination. See Qwest Billing Agreement, Exhibit D, § 14.1. However, if a balance remained in the bad debt reserve account after the 12 months have passed, then Qwest must pay such balance to the Contracting Debtors by the last business day of the following month. See Qwest Billing Agreement, Exhibit D, § 14.1. Accordingly, the balance of the bad debt reserve, \$805,853.56, was payable to the Contracting Debtors on September 30, 2005. In spite of repeated demands, the Contracting Debtors have not received such payment as of the filing of this Complaint.

18. Qwest has no legal right to setoff any of the Held Funds against amounts the Debtors may owe Qwest under unrelated service agreements. Nonetheless, Qwest continues to hold the Held Funds despite contractual provisions in the Qwest Billing Agreement requiring Qwest's return of the Held Funds to the Contracting Debtors.

CAUSES OF ACTION

COUNT ONE: TURNOVER OF PROPERTY OF THE ESTATE BY QWEST

19. Paragraphs 1-18 are incorporated herein as if set forth fully. The Held Funds are property of the Contracting Debtors' estates. Qwest should be ordered to immediately return the Contracting Debtors' property to their estates. 11 U.S.C. § 542(a) and (b).

**COUNT TWO: DECLARATORY JUDGMENT REGARDING QWEST'S
INABILITY TO SETOFF AGAINST THE HELD FUNDS**

20. Paragraphs 1-18 are incorporated herein as if set forth fully. An order should be entered declaring that Qwest holds no claim against, and has no right to setoff against the Held Funds.

21. In order to claim a right to setoff, Qwest must show: (1) a debt owed by Qwest to a specific Contracting Debtor prior to the commencement of the Cases remains outstanding; (2) Qwest has a claim against that same Contracting Debtor which arose prior to the commencement of the Cases; and (3) the debt and the claim are mutual obligations. See 11 U.S.C. § 553(a). Qwest cannot satisfy these criteria.

Qwest Does Not Meet the Mutuality Requirement

22. Qwest is unable to meet the mutuality requirement for proper setoff under Bankruptcy Code § 553 because its obligations flow to different entities. In addition to other requirements, Qwest must show (i) that Qwest is owed a specific amount by a single, specific Contracting Debtor; and, (ii) that the same single, specific Contracting Debtor owes the same Qwest entity a certain amount. Qwest cannot meet this “entity mutuality” requirement because Qwest’s claims, if any, are not against the same Contracting Debtor to whom it owes the Held Funds.

**An Agency Relationship Exists between Qwest and
the Contracting Debtors**

23. In its specific capacity of collecting end-user revenues on behalf of the Contracting Debtors pursuant to the Qwest Billing Agreement, Qwest acted as their collection agent. All risk of loss of non-payment by the Contracting Debtors’ respective end-user customers was borne solely by the Contracting Debtors, confirming that Qwest

acted solely in an agency role. Qwest cannot setoff amounts allegedly owed to it by the Contracting Debtors, wholly outside of this agency relationship (such as for fees due under other unrelated service agreements), against the amounts Qwest owes the Contracting Debtors in its capacity as their collection agent. Therefore, Qwest cannot overcome the hurdle of “capacity mutuality” under Bankruptcy Code § 553.

ATTORNEYS’ FEES, COSTS, AND DAMAGES

24. Qwest’s wrongful conduct has caused harm and expense to the Contracting Debtors’ estates. To compensate the Contracting Debtors for these losses, Qwest should be ordered to pay the Contracting Debtors’ reasonable attorneys’ fees, costs, and damages. Such compensation is merited under the equities of the case at hand.

PRAYER

VarTec seeks (i) an Order of this Court instructing Qwest to immediately turn over the Held Funds to the Contracting Debtors, together with interest thereon as provided by law for this time period during which such funds have been wrongfully withheld; (ii) an Order of this Court declaring that Qwest has no claims to, or right to setoff against the Held Funds; (iii) an Order of this Court awarding the Contracting Debtors their reasonable attorneys’ fees, costs, and damages; and (iv) granting the Debtors such other and further relief to which they may be justly entitled.

Dated: December 8, 2005

Respectfully submitted,

VINSON & ELKINS L.L.P.

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ATTORNEYS FOR THE DEBTORS

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