

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

IN RE:)
) BK. NO: 04-81694-SAF-11
VARTEC TELECOM, INC.)
DEBTOR)



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TRANSCRIPT OF PROCEEDINGS

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BE IT REMEMBERED, that on the 25th day of July,
2005, before the HONORABLE HARLIN D. HALE, United States
Bankruptcy Judge at Dallas, Texas, the above styled and
numbered cause came on for hearing, and the following
constitutes the transcript of such proceedings as hereinafter
set forth:

1 A P P E A R A N C E S

2 VINSON & ELKINS, L.L.P.
3 2001 Ross Avenue, Suite 3700
4 Dallas, Texas 75201
5 BY: Mr. Daniel Stewart
6 Mr. Richard London

7 APPEARING ON BEHALF OF THE DEBTORS

8 KILPATRICK STOCKTON
9 1100 Peachtree Street, Suite 2800
10 Atlanta, Georgia 30309
11 BY: Mr. Colin Bernardino

12 APPEARING ON BEHALF OF BELLSOUTH
13 TELECOMMUNICATIONS, INC.

14 THOMPSON & KNIGHT
15 1700 Pacific Avenue, Suite 3300
16 Dallas, Texas 75201
17 BY: Mr. John Brannon

18 APPEARING ON BEHALF OF SBC COMMUNICATIONS,
19 INC.

20 KANE, RUSSELL, COLEMAN & LOGAN
21 1601 Elm Street, Suite 3700
22 Dallas, Texas 75201
23 BY: Mr. Michael Scanlon

24 APPEARING ON BEHALF OF VARTEC TELECOM,
25 INC.

26 FULBRIGHT & JAWORSKI
27 2200 Ross Avenue, Suite 2800
28 Dallas, Texas 75201
29 BY: Mr. John Schwartz

30 APPEARING ON BEHALF OF RURAL TELEPHONE
31 FINANCE COOPERATIVE

32 WEIL, GOTSHAL & MANGES
33 200 Crescent Court, Suite 300
34 Dallas, Texas 75201
35 BY: Mr. James Grogan

36 APPEARING ON BEHALF OF MCI WORLDCOM
37 NETWORK SERVICES, INC.

1 CARRINGTON, COLEMAN, SLOMAN & BLUMENTHAL
2 200 Crescent Court, Suite 1500
3 Dallas, Texas 75201
4 BY: Mr. Jonathan Covin
5 Mr. Ken Carroll

6 APPEARING ON BEHALF OF OFFICIAL COMMITTEE
7 OF UNSECURED CREDITORS

8 GREENBERG, TRAURIG
9 13155 Noel Road, Suite 600
10 Dallas, Texas 75240

11 BY: Ms. Michelle Mendez

12 APPEARING ON BEHALF OF SPRINT

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1 P R O C E E D I N G S

2 THE COURT: I'll take appearances in VarTec.

3 MR. STEWART: Dan Stewart and Rich London for
4 the VarTec debtors from Vinson & Elkins, Your Honor.

5 THE COURT: Good morning.

6 MR. STEWART: Good morning.

7 MR. GROGAN: Good morning, Your Honor. James
8 Grogan, Weil, Gotshal & Manges for MCI Network Services and
9 MCI Communication Services.

10 MR. ARNETT: Good morning, Your Honor. Robert
11 Arnett for Connie Mitchell and Ronald Hughes.

12 THE COURT: Good morning.

13 MR. COVIN: Good morning, Your Honor. Jonathan
14 Covin and Ken Carroll for Carrington Coleman on behalf of the
15 Official Committee of Unsecured Creditors.

16 THE COURT: Good morning.

17 MR. CARROLL: Good morning, Your Honor.

18 MR. BRANNON: Good morning, Your Honor. John
19 Brannon with Thompson & Knight on behalf of the SBC Telcos.

20 MR. SCANLON: Good morning, Your Honor.
21 Michael Scanlon of Kane, Russell, Coleman & Logan as special
22 counsel for the debtors.

23 THE COURT: Good morning.

24 MR. SCHWARTZ: Good morning, Your Honor. John
25 Schwartz, Fulbright & Jaworski for the RTFC.

1 MS. MENDEZ: Good morning, Your Honor.
2 Michelle Mendez, Greenberg Traurig for Sprint.

3 THE COURT: Good morning.

4 I'll take appearances from folks on the telephone.

5 MR. DEE: Good morning, Your Honor. Terrence
6 Dee of White & Case on behalf of the Official Committee of
7 Exel Independent Representatives.

8 THE COURT: Good morning.

9 MR. BERNARDINO: Good morning, Your Honor.
10 Colin Bernardino on behalf of Bellsouth Telecommunications,
11 Inc., Kilpatrick Stockton.

12 THE COURT: Anyone else on the phone?
13 Mr. Stewart.

14 MR. STEWART: Thank you, Your Honor.

15 There's a very limited docket this morning per our
16 agenda letter filed Friday afternoon.

17 Before getting into the four matters on the docket, I
18 would like to introduce the Court to Michael Hoffman our
19 chief executive officer and sole board member who has been
20 actively involved in the cases. Michael was unable to be
21 here Friday afternoon for the hearing at that time and
22 otherwise has been at each and every hearing throughout the
23 case and is the voice of the debtor, the business. And very
24 much on the legal side having previously been general counsel
25 to the company and remaining general counsel today.

1 That being the case, there are four items on the docket
2 today. We at Vinson & Elkins are only going to handle item
3 number 3. Since I'm here, if I might just jump into that
4 one, Your Honor, because it's very straightforward and
5 simple.

6 The debtor had filed a number of -- a motion to reject a
7 number of circuit agreements with various third parties, both
8 as a cleanup matter and as a prospective matter relative to
9 circuit agreements we had with various carriers for
10 transmission of telephone calls and routing of telephone
11 calls. Many of these particular circuit agreements had
12 already been terminated as a business matter in any event.
13 So it's really just in those respects a cleanup matter.

14 We have drawn limited, or straightforward objections
15 from five parties, one of which was filed a little bit late.
16 But with respect to the responses we have received from
17 Wiltel Communications, MCI, Bellsouth, Broadwing, and Sprint
18 Spectrum, we've talked to counsel for each of those parties.
19 And with respect to those, we're going to continue our motion
20 to reject their covered circuit agreements until August 18,
21 which is the next omnibus hearing in the case. And with
22 respect to the others where there in essence has been
23 defaults or no responses filed by the counter-parties to our
24 circuit agreements, we will request the party to upload an
25 order authorizing their rejection.

1 As I indicated, the majority of which have already on a
2 business basis expired by their own terms, or otherwise been
3 terminated.

4 THE COURT: Okay. I read your motion and read
5 all of the objections.

6 Does anyone on the objecting side have any problem with
7 that process?

8 MR. GROGAN: Your Honor, James Grogan.

9 We filed a response, but we've agreed to a continuance.
10 And I think the form of order that I've seen here in the
11 court accurately reflects what we've agreed to.

12 THE COURT: Okay. Unless you speak up, I'll
13 assume that Mr. Stewart's proposal works for all of the
14 objecting parties. And I'll sign orders this afternoon,
15 Mr. Stewart. If you upload orders, I'll get one back to you
16 today some time.

17 MR. STEWART: Thank you, Your Honor.

18 And the three other matters on the docket are, the first
19 is a motion to assume a lease agreement with General
20 Electrical Capital which is being handled by our conflicts
21 counsel, Kane Russell. And then the second item on the
22 docket is SBC's, our motion relative to SBC's setoff request.
23 That too is being handled by Kane Russell being an SBC matter
24 where we have a conflict. And lastly is the Committee's
25 amended motion for certain 2004 Exams of non-debtor third

1 parties.

2 THE COURT: Okay.

3 MR. SCANLON: Your Honor, Mike Scanlon of Kane
4 Russell as special counsel to address matters 1 and 2 in the
5 agenda letter.

6 Matter number 1 is a motion to assume master lease
7 agreement between VarTec and General Electric Capital
8 Corporation, and particularly a specifically enumerated
9 master lease and particular schedule therein. The motion was
10 filed. No responses or objections have been received. And
11 with the Court's permission, I'll upload an order granting
12 the motion.

13 THE COURT: I didn't see any responses.

14 Anyone have a response to this motion?

15 I'll sign that order this afternoon if you'll upload it.

16 MR. SCANLON: Thank you, Your Honor.

17 As to item number 2, that's a motion to determine SBC'
18 ability to effectuate setoff and to compel return of funds
19 not subject to setoff filed by the -- filed by VarTec and
20 Exel.

21 As to that motion, Your Honor, I believe Mr. Coleman and
22 Mr. Bennett, SBC's counsel have conferred. And my
23 understanding is they're going to prepare and submit a
24 scheduling order. And what that scheduling order will do is
25 adopt and adversary proceeding timetable and basically adopt

1 an adversary proceeding framework that is similar to other
2 similar motions that were filed and converted to adversary
3 status. And what they would like to do is adopt the same
4 procedure with adjusted deadlines. And we request that we be
5 allowed to continue the matter to the next omnibus hearing
6 date which is August 18th. And that we treat that as a
7 status conference at that time.

8 My understanding is that the expectation is that the
9 order will be submitted to the Court before that time.

10 THE COURT: Okay. That's consistent with, I
11 didn't listen to the date Friday, but it's certainly
12 consistent with their announcement. So I'll sign an order on
13 this if you submit it.

14 MR. SCANLON: Thank you, Your Honor. That's
15 all of the items that I have.

16 THE COURT: Okay.

17 MR. SCANLON: Thank you, Your Honor.

18 THE COURT: Thank you.

19 Now we're down to the Committee's 2004 motion; is that
20 right?

21 MR. CARROLL: Good morning, Your Honor. Ken
22 Carroll for the Committee with respect to the 2004 Exam
23 motion.

24 Your Honor, we believe, as we did when we filed it that
25 this motion is a routine request for 2004 Exams and for

1 documents to analyze, to examine, to try to further
2 understand claims for relief which would, of course, affect
3 the estate of the debtors.

4 The Court previously has allowed four such 2004s. We
5 don't think these are really any different. This request
6 deals with, is directed to 2004 Exams of eight individuals,
7 non-debtor third parties. Two of the eight have already
8 agreed to the examinations and the dates. We have had one
9 objector for two people, for Connie Mitchell and for Ron
10 Hughes.

11 To summarize briefly, and the Court has probably seen
12 the objection, we got it late on Thursday. We did not file a
13 response, but we do obviously have some things to say about
14 it. To reset where we were, as the Court may know we did, in
15 fact, serve on behalf of the Committee for the benefit of the
16 debtors' estates a claims letter on May 26th. That was a day
17 just in advance of the expiration of the then existing D&O
18 policy coverage. And the Court may know there was some
19 exigency in the earlier 2004 for that reason. We only got
20 four of them done before that time passed.

21 Now what we're asking to do is to try to follow up and
22 expand upon it and refine the information that we got in
23 those original 2004.

24 Ms. Mitchell and Mr. Hughes have taken the position that
25 because we have sent them a claims letter, not filed a

1 lawsuit, not filed an adversary proceeding but have sent a
2 claims letter, which by the way we've received no response,
3 that we are precluded from using the 2004 mechanism at this
4 point to further examine issues that are addressed in the
5 conduct of the officers and directors that are made the
6 subject of that claims letter and likely to be made the
7 subject of an adversary proceeding.

8 They argue that adversary rule 7027 which deals with the
9 perpetuation of testimony through deposition, or the taking
10 of depositions during appeals or proceedings now governs and
11 therefore precludes the use of the 2004 process.

12 The fact is, though, they cite three cases in their
13 objection; the Enron case by Judge Gonzales; the Kip case,
14 and the Bennett case. And none of them deals with the
15 situation that is before this Court. In every instance the
16 Court in those cases was dealing with what is described and
17 actually quoted in every one of the cases as, quote, the
18 well-recognized rule that once an adversary proceeding or
19 contested matter has been commenced, discovery is made
20 pursuant to Federal Bankruptcy Rule 7026 rather than by
21 Federal Bankruptcy Rule 2004 Examination.

22 None of them deal with the situation where the 2004 Exam
23 is sought prior to the commencement of an adversary
24 proceeding or parallel proceeding in state court, or
25 something of the sort. In fact, in Enron, which I have some

1 passing familiarity because I'm involved in the case, not
2 only was there an existing lawsuit where the -- which had
3 been commenced by the party it was seeking a 2004 Examination
4 to the Board of Regions in the California System, but that
5 group was, in fact, the lead plaintiff in the Newby
6 securities litigation in which there was an automatic stay
7 under the Private Securities Litigation Reform Act which they
8 were somewhat actually trying to circumvent by seeking their
9 2004 Exams. And Judge Gonzales denied that request because
10 of the pendency of the parallel proceeding and not otherwise.

11 So, in fact, the rule that we have to deal with here is
12 that 2004s most of the time may be disallowed when there's a
13 pending proceeding already in place. But there's no
14 authority for doing it otherwise. In fact, to the contrary,
15 the only case that we were able to find that dealt with the
16 situation of pre-litigation where somebody had sought to
17 impose or invoke Rule 7027 prior to litigation rather than in
18 an appeal setting is a case called matter of Sutera,
19 S-u-t-e-r-a, 141 Bankruptcy 539 out of the Bankruptcy Court
20 in Connecticut, 1992.

21 THE COURT: What was the page? Oh, you have
22 the case?

23 MR. CARROLL: I have a copy, if I can give it
24 to the Court?

25 THE COURT: Thank you.

1 MR. CARROLL: And, again, I apologize. I
2 handed a copy of this to Mr. Arnett just before we began. I
3 was looking for Mr. Alibi, I didn't know Mr. Arnett was going
4 to handle it. So I just handed it to him just before we came
5 up here.

6 In this case the Court examined the application of Rule
7 7027 in a situation where as here the person resisting the
8 2004 was taking the position that the information was going
9 to be used in an expected adversary proceeding. And the
10 Court went through its analysis and, again, quoted the
11 customary rule that Court holdings and authority generally
12 concur that deposition and discovery rules of part 5 of the
13 Federal Rules of Civil Procedure, that would be Rules 26
14 through 37, apply only when contested matters or adversary
15 proceedings have been commenced and are pending. Only then
16 must Courts rule that 2004 may be inapplicable. And the
17 Court therefore rejected the argument that Rule 27 would
18 apply.

19 There, as here, the argument was made that there's not
20 an attempt here to perpetuate testimony, but simply to
21 attempt to continue to further understand the situation that
22 might, in fact, be the subject of an adversary proceeding.

23 Perhaps to drive that point home, in another case that
24 was decided last month locally -- if I can present the Court
25 with a copy of this, as well?

1 THE COURT: Okay.

2 MR. CARROLL: Judge D. Michael Lynn of the
3 Northern District --

4 THE COURT: Do you think that's good authority?

5 MR. CARROLL: I do. Particularly since I'm
6 going to see Judge Lynn on Wednesday.

7 Judge D. Michael Lynn examined a situation almost
8 identical to this in which Rule 7027 wasn't invoked, but
9 there had been considerable discussion of the likely
10 adversary proceeding against the Southern Company which was
11 the former parent of Mirant. And there was a request, again,
12 for 2004 Examinations. And in that circumstance -- and it
13 was the objection that I believe the argument was quoted as,
14 The production ought not to occur under Rule 2004 when it is
15 to aid litigation which is sure to be filed, which is
16 essentially the same argument that's been made here. Judge
17 Lynn, again, went through the analysis and determined that
18 that just didn't hold water. That, in fact, until the
19 lawsuit had been filed or the adversary proceeding had been
20 filed, there was no authority for doing that.

21 In fact, in looking at, some might say a technical
22 argument, but maybe not, he made the point that there's at
23 least a fair argument that until an adversary proceeding is
24 commenced, the 7000 series rules in the Bankruptcy Rules
25 don't even apply. So 7027 literally isn't applicable until

1 an adversary is commenced. But in any event, under the very
2 circumstance that we're looking at here, Judge Lynn on June
3 1, 2005 rejected this very argument and allowed the 2004s to
4 go forward. And I know for a fact, because I'm in that case,
5 as well, that the case against Southern, the thing that was
6 being discussed here was, in fact, filed within a few weeks
7 after Judge Lynn's decision.

8 So consistent with the decision in Mirant, the decision
9 in Sutera and, frankly, consistent with the authority cited
10 by the objector, Ms. Mitchell and Mr. Hughes, we respectfully
11 request that the Court grant the motion and allow us to
12 proceed with the 2004s.

13 THE COURT: Thank you, Mr. Carroll.

14 MR. CARROLL: Thank you.

15 MR. ARNETT: Thank you, Your Honor.

16 Your Honor, what the Courts in the Enron case and the
17 Bennett case were struggling with is, to what extent can
18 clever lawyers use 2004 to circumvent limitations on
19 discovery.

20 In this particular case we've already had one round of
21 2004 Examinations that have been concluded. Those led, those
22 produced information concrete enough at least in the minds of
23 the Committee to send a very detailed letter to a list of
24 officers and directors, not only putting them on notice and
25 asking them to put their insurance carrier on notice, but

1 also specifically making demand for monetary recovery.

2 Now we have a request for additional 2004 Examinations.
3 And what we foresee is an adversary that will be filed at
4 some point. And then the Committee having had -- having taken
5 however many depositions under Rule 2004 that it desires,
6 well, they can come back and want to re-depose all of these
7 people, again, under Rule 7030 and circumventing the
8 limitation on deposition in Rule 7030 that you only get one
9 day of seven hours.

10 The two cases that the Committee has cited to the Court
11 are distinguishable in the sense that in Sutera what was
12 going on was the -- a creditor had filed a proof of claim.
13 And the Trustee was attempting to get information about the
14 proof of claim. And the Court held that under those
15 circumstances that 2004 was an appropriate procedure to use.

16 The Mirant case in front of Judge Lynn didn't involve a
17 request for examination. It involved a request for
18 documents. And moreover, one of the factors that Judge Lynn
19 was concerned about there was that there was a looming
20 limitations problem. And since there was no adversary
21 proceeding commended at the time, 2004 was the only mechanism
22 by which information could be gotten in the face of a looming
23 limitations problem.

24 Here the petition was filed last November under 11 USC
25 108, any limitations that hasn't expired or extended for two

1 years from the day the petition was filed, that would be
2 November 2006. We've got obviously a long way to go before
3 then.

4 We have the situation where the Committee has -- is
5 ready. They've made a demand on all these people. They've
6 already taken examinations. They're ready to go. What
7 they're asking this Court to do is essentially let them
8 complete their deposition discovery before they have to file
9 the lawsuit where you don't have the procedural protections
10 that you do once a lawsuit is filed. And then they're going
11 to want to come back later on and re-depose all of these
12 people once they've actually filed the adversary.

13 And addressing this Court's equitable discretion, that's
14 inappropriate. That either the Committee has concrete enough
15 information to commence them to serve people the demand
16 letter, let's go ahead and get the adversary teed up and
17 start discovery as discovery normally proceeds in civil
18 litigation, rather than letting them have two bites at the
19 apple with all of these various witnesses.

20 Alternatively, if the Court is inclined to allow them to
21 examine these folks at this point, I would ask the Court to
22 make this examination subject to the limitation under Rule
23 7030. In other words, if they want to come back and re-
24 depose people, they've got to come before this Court.

25 And I would point out there's another significant

1 factor. That if you take the Committee's argument to its
2 conclusion, it would eviscerate this Court's discretion under
3 Rule 2004. They've got to come to this Court and get
4 permission to examine somebody under Rule 2004. Their basic
5 position is, so long as they've got some colorable basis,
6 they have an absolute right to examine people, provided they
7 haven't actually filed an adversary. And I think that's a
8 misconception of the rule.

9 THE COURT: Thank you, Mr. Arnett.

10 MR. ARNETT: Thank you.

11 THE COURT: Mr. Carroll, it's your motion. You
12 get to go last.

13 MR. CARROLL: Thank you, Your Honor.

14 THE COURT: What about the proposal that it
15 count on the deposition time, is that something that you-all
16 have talked about, or thought about?

17 MR. CARROLL: Your Honor, I think the answer to
18 that probably is, is that that's probably a decision that
19 ought to be made, if at all, when the adversary is filed.
20 The argument certainly can be teed up at that point that an
21 examination has been conducted and perhaps there ought to be
22 some affect on a deposition if need be at that point. At
23 this point we are not at the point where information and
24 facts have been developed sufficiently that that sort of
25 thing should -- that that sort of rule should obtain, we'd

1 argue.

2 THE COURT: How long -- I know you have a list
3 of eight or ten people you want to depose to get ready for
4 the hearing. How long do you think these depositions are
5 going to take?

6 MR. CARROLL: Some of them are set for, are
7 actually set for half days and some of them are full days.
8 We actually don't at this point anticipate that any one of
9 them would go within a full day. I know 2004s can on
10 occasion.

11 I will also say that there's four that we took
12 previously. Actually, one of them we only got about half way
13 through now, maybe not even halfway through. But we
14 attempted to take three in two days. We got two of them done
15 and one of them not quite so done. The other, the last we
16 did on a single day. And we'd anticipate the same thing
17 here. And so, frankly, we just suggest that at this point
18 it is too early to try to say that this is a deposition
19 because we don't, of course, have all of the document
20 discovery and other things that you would normally have in a
21 deposition situation in the court. It may be that when the
22 time comes for the adversary proceeding and if we ask for a
23 deposition of one of these folks again, that those arguments
24 might need to be entertained. I don't know. I'd probably
25 say no when the time came, to be honest with you. But at

1 this point I think it's just too early to do it.

2 As to the other procedural protections. Clearly counsel
3 has been present and has been allowed to participate, counsel
4 for the witness in each case. And I would certainly
5 anticipate that that would happen here. We don't have any
6 kind of problem with that. So, again, I think ultimately
7 what you get down to is Judge Lynn's and the Sutera decision
8 and, frankly, 7027 just doesn't apply in this circumstance.

9 As to the issue of whether or not the Court has
10 discretion on the 2004s, of course the Court has discretion.
11 But, what the Court hasn't heard is that there's really any
12 issue that these folks have or could have material
13 information with respect to the ends and outs and the details
14 of these potential claims. The only objection is that
15 there's a concern about the amount of time that they might
16 have to sit or otherwise. And, of course, I guess, again,
17 that's only brought with respect to Mrs. Mitchell and
18 Mr. Hughes. We haven't heard anything to the contrary from
19 the other folks.

20 So in this circumstance we again urge the Court simply
21 given the fact that we do have continuing obligation before
22 we file the lawsuit under Rule 9011 or an adversary
23 proceeding under 9011, or under Federal CP 11 to continue the
24 investigation and to do the investigation that we need to do
25 that the Court allow us to pursue these 2004 Exams.

1 Thank you.

2 THE COURT: Give me just a minute.

3 The Court's ruling will be as follows.

4 The Committee's motion will be granted. Upon reading of
5 Rule 2004 and the case law is that until an adversary or a
6 lawsuit is filed the rule is available to a party in
7 interest.

8 This ruling is without prejudice to Mr. Arnett's client
9 seeking a limitation or protective order in the event that a
10 lawsuit is ultimately filed against them. That request will
11 be taken up at that time.

12 Anything further from either side?

13 MR. STEWART: Nothing further, Your Honor.

14 THE COURT: We'll be in recess.

15 Mr. Carroll, if you'll let Mr. Arnett just see that
16 order so that it preserves his clients' rights, I'll sign it
17 upon receipt.

18 MR. CARROLL: We'll do that, Your Honor. Thank
19 you.

20 THE COURT: Thank you.

21 (End of Proceedings.)

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C E R T I F I C A T E

I, CINDY SUMNER, do hereby certify that the foregoing constitutes a full, true and complete transcription of the proceedings as heretofore set forth in the above-captioned and numbered cause in typewriting by me.

CINDY SUMNER, CSR #5832
Certified Transcriber
Expires 12-31-05
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