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**ATTORNEYS FOR THE DEBTORS**

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

<b>In re:</b>	§	
	§	
<b>VARTEC TELECOM, INC., et al.,</b>	§	<b>CASE NO. 04-81694-SAF-11</b>
	§	
<b>DEBTORS.</b>	§	<b>(Chapter 11)</b>
	§	<b>(Jointly Administered)</b>

**APPLICATION TO EMPLOY KANE, RUSSELL, COLEMAN  
& LOGAN, P.C. AS SPECIAL COUNSEL**

**TO THE HONORABLE STEVEN A. FELSENTHAL, UNITED STATES CHIEF  
BANKRUPTCY JUDGE:**

The above-referenced debtors and debtors-in-possession (collectively, the "Debtors")<sup>1</sup> file this Application to Employ Kane, Russell, Coleman & Logan, P.C. as Special Counsel (the "Application") and in support thereof respectfully states the following:

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<sup>1</sup> The Debtors include VarTec Telecom, Inc., Excel Communications Marketing, Inc., Excel Management Services, 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.

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

## **STATEMENT OF FACTS**

### **VarTec and Its Business**

5. VarTec Telecom, Inc., a Texas corporation ("VarTec"), along with its sixteen direct and indirect domestic subsidiaries, each of which is a Debtor, and eighteen non-debtor direct and indirect foreign subsidiaries (collectively, the "VarTec Entities"), is among the largest privately held companies providing telecommunications services in North America and Europe. The VarTec Entities, founded in DeSoto, Texas in February 1989, with current employees totaling over 1,300 worldwide (including approximately 1,000 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 \$900,000,000. VarTec's revenues have been derived primarily from three sale

distribution channels: (a) Direct Marketing; (b) Commercial Services; and (c) Multi-Level Marketing.

6. 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 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.

7. 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 markets 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.

8. 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.

9. Through the Multi-Level Marketing channel, which is managed by Excelcom, Inc. and certain of its subsidiaries (collectively, “Excel”), Excel offers 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, has an international network of over 130,000 independent representatives who market Excel’s products and services to small business and residential consumers and recruit new independent representatives to market such products and services. Each independent representative receives 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”), the usage of Excel products and services by customers of the independent representative and a portion of their downline.

### **The Industry**

10. 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 (the “Telecommunications

Act”), which was enacted to promote competition in the local telecommunications industry, ILECs were required to provide competitors, such as the Debtors, access to their networks to allow those competitive local exchange carriers (the “CLECs”) 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 FCC and various state agencies or public utility commissions. As consideration for relinquishing their monopoly positions, the ILECs were authorized to offer long distance telecommunications services, both out-of-region and in-region (where they were an ILEC) provided certain terms and conditions were satisfied.

11. ILECs, CLECs, and long distance carriers utilize each other’s networks to transmit the voice and data traffic of their customers. The framework and pricing of the exchange of voice and data traffic between ILECs and CLECs, on the one hand, and long distance carriers, on the other hand, is governed by multiple laws, regulations, tariffs, and interconnection agreements. For example, if an ILEC or a CLEC’s customer originates a call that is carried to its destination by one of the Debtors, the respective Debtor will bill the CLEC or ILEC on a minute of use basis; if a customer of one of the Debtors originates a call that is carried to its destination by an ILEC or a CLEC, the ILEC or CLEC will bill the respective Debtor on a minute of use basis. This is known as reciprocated or intercarrier compensation.<sup>2</sup>

12. To effectuate the billing, collection, and maintenance of account information, the Debtors often entered into agreements with various ILEC and CLEC, under which such ILEC or CLEC bills customers for the services provided by the

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<sup>2</sup> A long distance carrier can also be an ILEC or a CLEC.

Debtors, collects the billed amount for the Debtors, and pays or remits to the Debtors the collected amounts periodically.

13. The deregulation of local and long distance telecommunication services pursuant to the Telecommunications Act resulted in increased competition and decreased local and long distance rates. Despite successfully competing in the telecommunications industry for almost fifteen years, (i) VarTec's lack of brand name recognition comparable to some of its competitors in the more intensively competitive telecommunications market, (ii) customer attrition exacerbated by aggressive customer win-back campaigns by the dominant telco providers, and (iii) the margin compromises caused by increasing wholesale rates while retail rates are suffering, have all made it difficult for VarTec to maintain its historical revenue and profitability levels.

### **Legal Challenges**

14. In the weeks preceding the Petition Date, several ILECs, CLECs, and long distance carriers with whom the Debtors have interconnection or access agreements have (i) threatened to terminate services provided to the Debtors, (ii) requested security deposits, and/or (iii) offset amounts owed to the Debtors. The actions of the ILECs, CLECs, and long distance carriers have impaired the Debtors' liquidity.

15. In September 2004, SBC Communications, Inc. ("SBC") and other similarly-situated companies filed suit against VarTec Telecom, Inc. and several other entities in the United States District Court for the Eastern District of Missouri, Eastern Division. In that litigation (the "Missouri District Court Litigation") SBC and the other plaintiffs allege that VarTec and the other defendants failed to pay legally required charges for their use of the plaintiffs' local network facilities to complete long-distance calls.

16. On or about October 18, 2004, VarTec filed suit in the district court of Dallas County, Texas seeking injunctive and other relief against the plaintiffs in the Missouri District Court Litigation (the "Texas State Court Litigation"). The court in the Texas State Court Litigation subsequently issued a temporary restraining order (the "Original TRO"). On or about October 27, 2004, SBC filed a notice of removal regarding the Texas State Court Litigation, and removed the Texas State Court Litigation to the United States District Court for the Northern District of Texas, Dallas Division (the "District Court"). The action is now pending before the District Court as Civil Action No. 304-CV-2325P (the "Texas District Court Litigation"). On or about November 1, 2004 (and several hours after the Debtors filed their respective voluntary petitions), the District Court entered an order extending the Original TRO through November 17, 2004.

### **RELIEF REQUESTED**

#### **Reasons for Selection of KRCL as Special Counsel**

17. The Debtors wish to employ the law firm of Kane, Russell, Coleman & Logan, P.C. ("KRCL") as special counsel to assist Debtor VarTec Telecom, Inc. with bankruptcy issues that may arise in connection with the Missouri District Court Litigation, the Texas State Court Litigation, and the Texas District Court Litigation (collectively, the "SBC Litigation Matters").<sup>3</sup> The Debtors previously filed an application seeking to retain the law firm of Lynn Tillotson & Pinker, L.L.P. ("Lynn Tillotson") as special litigation counsel regarding the SBC Litigation Matters. The Debtors anticipate that KRCL will assist the Debtors and Lynn Tillotson by providing KRCL's expertise in bankruptcy matters arising from and related to the SBC Litigation.

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<sup>3</sup> Due to certain conflicts involving prior representation of SBC and its related entities, counsel for the Debtors cannot represent the Debtors in the SBC Litigation. Accordingly, the selection of other bankruptcy counsel was deemed necessary.

18. The Debtors believe that the employment of KRCL will provide effective and efficient bankruptcy counsel to the Debtors in matters relating to the SBC Litigation. Additionally, the Debtors believe that the employment of KRCL will serve the best interests of the Debtors' estates and the creditors, because the joint handling of the SBC Litigation by Lynn Tillotson and KRCL will ensure that the Debtors' main bankruptcy counsel can focus on other issues in the Debtors' Cases. The Debtors and their chief bankruptcy counsel will closely monitor the services provided by Lynn Tillotson and KRCL to ensure that there is no duplication of services.

19. The name, mailing address and telephone number of the lead attorney from KRCL is:

Joseph M. Coleman  
Kane, Russell, Coleman & Logan, P.C.  
3700 Thanksgiving Tower  
1601 Elm Street  
Dallas, Texas 75201-7207  
(214) 777-4200

Other attorneys from KRCL will participate in the representation as necessary.

20. Pursuant to Bankruptcy Code section 327(a) and Bankruptcy Rule 2014 and for the reasons given above, the Debtors wish to retain KRCL as special counsel as of the Petition Date.

### **Proposed Arrangement for Compensation**

21. The Debtors have agreed, subject to the Court's approval, to pay fees to KRCL based upon time spent in rendering legal services at the same hourly rates that KRCL charges its other clients for similar work. The hourly rates of the attorneys expected to perform legal services hereunder generally range from \$200 to \$400 for

partners and associates<sup>4</sup>. The hourly rate of the paraprofessionals expected to perform services hereunder generally range from \$50 to \$125. In addition, the Debtors have agreed to reimburse KRCL for its out-of-pocket expenses for rendering such services.

22. All the attorneys who provide services to the Debtors will maintain billing records setting forth complete and detailed activity descriptions including a time allotment billed in increments of one-tenth of an hour. Each activity will include a description of the type and subject matter of the activity undertaken, and activity descriptions will not be lumped together. Activity descriptions will be presented chronologically within each project category.

23. All compensation payable to KRCL by the Debtors with respect to the post-Petition Date period will be subject to Court approval in accordance with Bankruptcy Code sections 330 and 331, the Bankruptcy Rules, the Local Bankruptcy Rules, the orders of this Court, and this Court's Order Establishing Procedure for Monthly and Interim Compensation and Reimbursement of Expenses for Case Professionals, entered on November 4, 2004 (the "Compensation Order").

### **KRCL's Disinterestedness**

24. To the best of the Debtors' knowledge, the attorneys at KRCL do not have any connection with the Debtors, the Debtors' creditors, or any other parties in interest, their respective attorneys and accountants, the United States Trustee, or any person employed in the Office of the United States Trustee, except as disclosed in the Declaration of Joseph M. Coleman in Support of the Application to Employ Kane, Russell, Coleman & Logan, P.C. as Special Counsel, attached as Exhibit "A."

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<sup>4</sup> It is anticipated that KRCL's hourly rates will increase effective as of January 1, 2005, such that the highest hourly rate charged by KRCL's partners and associates will increase to \$425.



**KANE, RUSSELL, COLEMAN & LOGAN,  
P.C.**

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By: /s/ Joseph M. Coleman  
Joseph M. Coleman, SBT #04566100  
Robert J. Taylor, SBT #19721200

**PROPOSED SPECIAL COUNSEL FOR THE  
DEBTORS**

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