Hearing Date: July 30, 2004 at 10:00 a.m.

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
Four Times Square
New York, New York 10036-6522
(212) 735-3000
Jay M. Goffman (JG 6772)
J. Gregory St. Clair (GS 8344)
Frederick D. Morris (FM 6564)

Attorneys for Debtors and Debtors-in-Possession

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	:	Chapter 11
RCN CORPORATION, et al.,	:	Case No. 04-13638 (RDD)
Debtors.	:	(Jointly Administered)

DEBTORS' OBJECTION TO MOTION OF OFFICIAL COMMITTEE OF UNSECURED CREDITORS FOR ENTRY OF ORDER, UNDER 11 U.S.C. § 105(a), ESTABLISHING CERTAIN NOTICE PROCEDURES REGARDING THE OPERATION OF DEBTORS' BUSINESS

RCN Corporation ("RCN") and certain of its direct and indirect subsidiaries, debtors and debtors-in-possession in the above-captioned cases (collectively, the "Debtors"), hereby submit this objection to the Motion of Official Committee of Unsecured Creditors for Entry of Order, Under 11 U.S.C. § 105(a), Establishing Certain Notice Procedures Regarding the Operation of Debtors' Business (the

"Motion"). In support of this objection, the Debtors respectfully represent as follows:

PRELIMINARY STATEMENT

1. By the Motion,[1] the Official Committee of Unsecured Creditors (the "Creditors' Committee") is asking the Bankruptcy Court to issue an order that would impose restrictions on the business operations of the Debtors' non-debtor affiliates (the "Non-Debtor Affiliates"), even though they are not debtors in these chapter 11 cases and have no connection, contractual or otherwise, to the Creditors' Committee. Specifically, the Creditors' Committee is asking the Bankruptcy Court to issue an order that would:

> (i) require the Debtors to provide five business days written notice to the Creditors' Committee before any Non-Debtor Affiliate would be permitted to take certain actions that would otherwise be, under fundamental principles of corporate law, within the sole discretion of such Non-Debtor Affiliate's officers and directors — the order would also authorize the Creditors' Committee to request an expedited hearing on shortened notice regarding any attempt by a Non-Debtor Affiliate to take such action without the Creditors' Committee's prior consent; and
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> (ii) impose on the Debtors an obligation to cause the Non-Debtor Affiliates to take affirmative action, subject to an amorphous "reasonable and appropriate" standard, to protect the Non-Debtor Affiliates' assets — the order would also authorize the Creditors' Committee to request an expedited hearing on shortened notice regarding any alleged failure of a Non-Debtor Affiliate to take such action.

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[1] Capitalized terms not otherwise defined shall have the meanings ascribed to them in the Motion.

2. As discussed below, the Motion seeks to usurp the decision-making authority that, under well-established principles of corporate law, is properly vested solely in the directors and officers of the Non-Debtor Affiliates. The Creditors' Committee provides no justification for such extraordinary relief, and cites just two cases in support of its request, both of which are factually distinguishable and otherwise irrelevant to the extraordinary relief requested in the Motion.

3. Nor has the Creditors' Committee even made any allegation that the officers and directors of the Non-Debtor Subsidiaries are not fulfilling their fiduciary duties, or that the Non-Debtor Subsidiaries are being mismanaged in any way. Not surprisingly, there is no case law supporting the relief requested in the Motion. In fact, significant controlling authority makes it clear that bankruptcy courts lack the requisite jurisdiction, in the absence of compelling facts not present here, to grant such relief. So even if the relief requested by the Creditors' Committee were otherwise appropriate, which it is not, the Bankruptcy Court does not have jurisdiction, under these facts, to grant such the requested relief. Accordingly, the Court should deny the extraordinary and novel relief requested in the Motion.

ARGUMENT

A. The Relief Requested is Contrary to Fundamental Principles of Corporate Law

4. One of the fundamental principles of corporate law is that sole discretion to make decisions on behalf of a corporation is vested entirely in the board

of directors,[2] which may appoint officers to run the day-to-day operations of the corporation.[3] The Creditors' Committee essentially is asking the Court, without any justification or precedent, to strip such authority from the directors and officers of the Non-Debtor Affiliates and vest it in Creditors' Committee.

5. In managing the corporate enterprise, a corporation's officers and directors must adhere to fiduciary duties imposed by the applicable corporation statutes and case law. See, e.g., Revlon, 506 A.2d at 179 n.8 ("In discharging this function the directors owe fiduciary duties of care and loyalty to the corporation and its shareholders."). These principles underlie the business judgment rule, a corner-stone of corporate jurisprudence which provides that the actions of a corporation's directors and officers are presumptively valid. As the Bankruptcy Court for the

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[2] See Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173, 179 (Del. 1986) ("[t]he ultimate responsibility for managing the business and affairs of a corporation falls on its board of directors"). This principle is embodied in state corporation statutes, including section 701 of the New York Business Corporation Law (the "BCL")("the business of a corporation shall be managed under the direction of its board of directors") and section 141 of the Delaware General Corporation Law (the "DGCL")("[t]he business and affairs of every corporation organized under this chapter shall be managed by or under the direction of a board of directors").

[3] See, e.g., BCL § 715 ("The board may elect or appoint [officers] . . . . All officers . . . shall have such authority and perform such duties in the management of the corporation as may be provided in the by-laws or, to the extent not so provided, by the board"); see also DGCL § 142 ("Every corporation organized under this chapter shall have such officers with such titles and duties as shall be stated in the bylaws or in a resolution of the board . . . .").

Southern District of New York recently stated, "[t]he business judgment rule's presumption shields corporate decision-makers and their decisions from judicial second-guessing." See In re Adelphia Communications Corp., No. 02-41729 (REG), 2003 Bankr. LEXIS 1281, at *109 (Bankr. S.D.N.Y. Mar. 4, 2003)(citing In re Integrated Resources, 147 B.R. 650, 656 (S.D.N.Y. 1992)). Only in the most extreme and egregious circumstances may a court step in to limit or second-guess the decisions of a corporation's directors or officers. See In re Integrated Resources, 147 B.R. at 656 ("Courts are loathe to interfere with corporate decisions absent a showing of bad faith, self-interest, or gross negligence," and for that reason, "[c]ourts will uphold the board's decisions as long as they are attributable to any rational business purpose.")(citations omitted). The Bankruptcy Court for the Southern District of New York recently held that business judgment rule principles apply even in the chapter 11 context. See In re Adelphia, 2003 Bankr. LEXIS at *108–09 (stating that Delaware authorities interpreting business judgment rule principles have "have vitality by analogy" in Delaware corporation's chapter 11 proceedings)(citing In re Integrated Resources, 147 B.R. at 656).

6. The proponent of interference with director and officer discretion to manage a corporation's affairs must overcome a heavy burden of proof to demonstrate that such relief is warranted. The proponent must furnish competent evidence demonstrating that some or all of the following factors are lacking: "(1) the

existence of a business decision, (2) disinterestedness, (3) due care, (4) good faith, and (5) according to some courts and commentators, no abuse of discretion or waste of corporate assets." In re Integrated Resources, 147 B.R. at 656. The Creditors' Committee has offered no such proof, and has made no allegations of mismanagement, abuse, or breach of fiduciary duty with respect to the management of the Non-Debtor Affiliates, yet they are asking the Court to cast aside this substantial body of jurisprudence and impose a protocol that would impede the discretion of the directors and officers to manage the Non-Debtor Affiliates. The Creditors' Committee is seeking novel and unprecedented relief that would usurp decision-making authority that is properly vested in a corporation's directors and officers, and so the Court should deny their request for such relief.

B. The Motion Provides no Authority or Other Justification to Support the Relief Requested

7. The relief requested in the Motion would directly and adversely affect the Non-Debtor Affiliates because it would interfere with the discretion of each entity's directors and officers to manage their respective entity's business. In support of the Motion, the Creditors' Committee cites only two cases, Queenie, Ltd. v. Nygard International, 321 F.3d 282 (2d Cir. 2003) (hereinafter, "Queenie") and Ruskin v. Griffiths, 250 F.2d 875 (2d Cir. 1958)(hereinafter, "Ruskin"). Both of these cases are inapposite to the relief requested in the Motion and do not provide a basis upon which this Court should grant such relief.

8. Queenie involved the scope of the stay of proceedings under section 362(a) of the Bankruptcy Code. In Queenie, a third party had obtained monetary judgments against the individual debtor, his wholly-owned corporation, and two unrelated entities. Id. at 286. Both the individual debtor and his wholly-owned corporation appealed the judgments. The individual debtor then filed for chapter 11 protection, but his wholly-owned corporation did not. Counsel for the individual debtor argued that the section 362(a) stay of proceedings should prevent the appeal from proceeding with respect to both the individual chapter 11 debtor and his wholly-owned corporation (not a chapter 11 debtor). Id. at 287. Significantly, the judgment creditor did not oppose the application of the stay of proceedings to both the chapter 11 debtor and the non-debtor corporation. Id. The Court of Appeals for the Second Circuit ordered a stay of the proceedings with respect to the chapter 11 debtor and the non-debtor corporation, but not with respect to the other non-debtor co-defendants. Id. The Queenie court articulated a rule that the automatic stay might apply to an action against a non-debtor but "only when a claim against the non-debtor will have an immediate adverse economic consequence for the debtor's estate." Id. Examples of such situations include a claim to establish an obligation with respect to which the debtor is a guarantor, a claim against the debtor's insurer, and an action where "there is such identity between the debtor and the third-party

defendant that the debtor may be said to be the real party defendant." Id. at 287–88 (citations omitted).

9. In the present case, the Creditors' Committee has not established why the Queenie rule, formulated in a context where the issue was whether to apply the automatic stay to an action against a non-debtor subsidiary, should mandate the unwarranted and unprecedented interference with the management of a non-debtor. Nor is there any factual or legal basis for such an extension of the Queenie rule. In fact, the Motion completely ignores binding Second Circuit precedent and fails to even mention the decision in In re Beck Indus., Inc., 479 F.2d 410 (2d Cir. 1973)(hereinafter "Beck"), discussed below, and its requirement of a showing, prior to piercing the corporate veil of a debtor's non-debtor subsidiary to treat its assets as part of a debtor's estate, that such non-debtor subsidiary is a "mere sham or conduit rather than a viable entity."

10. It is also noteworthy that the Queenie case involved an individual debtor who was the sole shareholder and president of the non-debtor subsidiary, which presents a much stronger case for a court finding a sufficient identity of interests to effectively disregard the separate identity of the corporate subsidiary. By contrast, RCN is a publicly-held corporation and each of the other Debtors and the Non-Debtor Affiliates is a separate, distinct and viable corporate entity. Finally, and possibly most significantly, the court in Queenie noted that the

debtor requested the application of the stay to the non-debtor and his wholly-owned corporation, and the judgment creditor expressly acquiesced in such an application of the stay. Id. at 287.

11. The Creditors' Committee also relies on Ruskin in support of its Motion. In Ruskin, the Second Circuit granted the reorganization trustee's request to require notice to the trustee and/or the court of certain proposed actions by a secured creditor who was managing the debtor's non-debtor subsidiaries pursuant to a collateral agreement which had been executed when the debt was incurred. The reorganization trustee's request for notice was granted in conjunction with the court's entry of an order denying this same secured creditor's request to vacate the bankruptcy stay of proceedings so the secured creditor could foreclose on the debtor's property.

12. Ruskin involved a situation very different from the present cases and the relief requested in the Motion — in Ruskin, the non-debtor subsidiaries had a very real connection to the bankruptcy proceedings because they were being managed by the debtor's secured lender pursuant to a security agreement executed when it loaned the debtor money. There is no such connection, contractual or otherwise, between the Non-Debtor Affiliates and the Creditors' Committee. Additionally, in Ruskin it was the trustee, standing in the shoes of the debtor for purposes of the bankruptcy proceedings, who was to receive notice. In the case at

hand it is the Creditors' Committee, as the representative of the Debtors' unsecured creditors, that is requesting notice and express authorization to request an expedited hearing on shortened notice. These distinctions are critical.

13. Moreover, the Motion requests that the Debtors — as opposed to the frustrated secured creditor in Ruskin who had attempted to foreclose on the debtor's assets and was managing the debtor's non-debtor subsidiaries pursuant to a security agreement — be compelled to enter into a protocol that would essentially require the Non-Debtor Affiliates to conduct their businesses as though they were chapter 11 debtors. The relief requested in the Motion is not akin to the relief granted in Ruskin, it is novel and unprecedented, and thus it is totally unwarranted.

C. The Court Lacks Jurisdiction to Grant the Requested Relief

14. Case law in the Second Circuit and the Southern District of New York case law clearly establishes that bankruptcy courts do not have jurisdiction over non-debtor subsidiaries and their assets, except in situations where the subsidiary is a "sham." In re Unishops, Inc. (2d Cir. 1974) ("[T]he bankruptcy court cannot expand its jurisdiction over a debtor's subsidiary absent a showing that the subsidiary is a mere sham rather than a viable entity. . . . The fact that the parent may have assumed liability for the debts of its subsidiaries does not alter their corporate vitality."); see also Beck, 479 F.2d at 415–17 (holding that bankruptcy court lacked jurisdiction to enjoin state law suit against non-debtor subsidiary despite fact that it

would adversely affect the value of the subsidiary's assets and thus the value of the Debtors' interest in the subsidiary); In re Mego Int'l, Inc., 30 B.R. 479, 481 (S.D.N.Y. 1983)("Beck established that the ownership of a subsidiary by a bankrupt parent does not make that subsidiary the parent's property, unless the subsidiary is "a mere sham or conduit rather than a viable entity."); In re Wm. Gluckin Co. Ltd. (S.D.N.Y. 1978) ("Mere corporate affiliation with the Debtors will not support this Court's extension of jurisdiction beyond parties involved in the present proceedings.").

15. The Second Circuit in Beck expressly rejected the notion that a bankruptcy court has jurisdiction over a non-debtor subsidiary or its assets with respect to matters that might lower the value of the debtor's equity interests in such non-debtor subsidiary; nevertheless, this is precisely what the Creditors' Committee is asking the Court to do in these cases. In the Beck case, the Second Circuit reversed the district court's initial holding that a non-debtor subsidiary's assets constituted "property" of the Debtor's estate and, thus, bankruptcy court jurisdiction was proper. Id. at 412. The Second Circuit noted that the lower court holding "was based on the premise that Subsidiary was a mere adjunct or instrumentality of the debtor, permitting the court to disregard its separate corporate existence and pierce the corporate veil." Id. at 410. Because there was no evidence that the subsidiary was "a mere sham or conduit rather than a viable entity," the Second Circuit found no

grounds for piercing the subsidiary's corporate veil and treating its assets as part of the estate. Id. at 416.[4]

16. The Bankruptcy Court for the Southern District of New York has affirmed that Beck "remains good law even though it was decided under the former Bankruptcy Act." In re Clifford Resources, Inc., 24 B.R. 778, 480 (Bankr. S.D.N.Y. 1982) (citing Beck as "directly on point" and holding that bankruptcy court lacked jurisdiction over matter concerning assets of non-debtor partnership in which debtor was general partner, notwithstanding that the matter could diminish the value of non-debtor partnership's assets and thereby reduce the value of debtors' general partnership interest). The Second Circuit in In re Unishops also confirmed that a bankruptcy court lacks jurisdiction over a non-debtor subsidiary and its assets, even if the matter relates to the non-debtor subsidiary's guarantee of certain debts of the debtor which could thereby affect the debtor's ultimate liability on its debts — bankruptcy court jurisdiction is proper only if the subsidiary is "a mere sham rather than a viable entity," and "[t]he fact that the parent may have assumed liability for the

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[4] Beck refers to In re Gobel, Inc., 80 F.2d 849 (2d Cir. 1936) as "the leading case" on this issue and cites it as establishing the distinction between a debtor's equity interest in a non-debtor subsidiary, which is part of the debtor's estate, and the assets of such non-debtor subsidiary, which are not. Beck, 479 F.2d at 416 (citing In re Gobel, 80 F.2d at 852 (holding that bankruptcy court lacked jurisdiction over a matter that would affect the assets of, but not the equity interests in, a non-debtor subsidiary)).

debts of its subsidiaries does not alter their viability." In re Unishops, 494 F.2d at 690.

17. The Non-Debtor Affiliates are not "mere shams or conduits" for RCN and the other Debtors in these cases, and the Motion contains no allegation to the contrary. The Non-Debtor Affiliates are distinct, viable corporate entities. Accordingly, it is unwarranted and would be unprecedented for a bankruptcy court to take the extraordinary and intrusive step of putting the Creditors' Committee in a position of interfering with, and potentially divesting the Non-Debtor Affiliates' directors and officers of, their fiduciary duties and responsibilities for managing the businesses and assets of their respective entities.

18. Even without this jurisdictional impediment there is absolutely no authority or justification for the unprecedented and extraordinary relief requested in the Motion. Such relief is therefore unwarranted, especially considering that it directly contravenes the well-established principles of corporate law discussed above. Moreover, and significantly, there is no suggestion in the Motion that the directors and officers of the Non-Debtor Affiliates are mismanaging their assets or businesses in any way that would adversely affect the Debtors' interest in the Non-Debtor Affiliates. For these reasons, the Court should not grant the relief requested in the Motion.

WHEREFORE, the Debtors respectfully request that the Court enter an order (i) denying the Motion and (ii) granting such other and further relief as is just and proper.

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July 27, 2004

SKADDEN, ARPS, SLATE, MEAGHER
& FLOM LLP

/s/ J. Gregory St. Clair
Jay M. Goffman (JG 6722)
J. Gregory St. Clair (GS 8344)
(Members of the Firm)
Frederick D. Morris (FM 6564)
Four Times Square
New York, New York 10036-6522
(212) 735-3000

Attorneys for Debtors and
Debtors-in-Possession