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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)

**RESPONSE OF EDWARD T. JOYCE TO DEBTORS' SECOND
OMNIBUS OBJECTION PURSUANT TO 11 U.S.C. §§ 502(b) AND 510(b)
AND FED. R. BANK. P. 3003 AND 3007 TO CLAIMS**

Edward T. Joyce (“Joyce”), individually and as 21st Century Telecom Group, Inc. (“21st Century”) Shareholder Representative, by its counsel, Nixon Peabody LLP, hereby responds to the second omnibus objection to claims (the “Second Omnibus Claims Objection”) filed by the above-captioned debtors and debtors in possession (the “Debtors”) and, in support, respectfully states as follows:

BACKGROUND

1. On August 12, 2004, Joyce timely filed two separate proofs of claim, Claim Nos. 1509 and 1510, against RCN Corporation (“RCN”). Joyce was a significant stockholder and director (chairman of the board) of 21st Century, an Illinois corporation engaged in the business of providing bundled telecommunications services in Chicago, Illinois area. During December 1999, 21st Century was merged into RCN, one of the Debtors, in a stock for stock transaction. 21st Century became RCN Telecom Services of Illinois, Inc., a wholly owned subsidiary of RCN. On or about December 12, 1999, 21st Century, RCN and 21st Holding Corp. executed the merger agreement (the “Merger Agreement”), which designates Joyce as the 21st Century “Shareholder

Representative” giving Joyce the exclusive authority to represent the former shareholders of 21st Century in certain matters arising from the Merger Agreement.

2. Claim No. 1509 asserts a general unsecured claim in the amount of \$20 million plus damages, interest, attorney’s fees and costs (copy annexed hereto as Exhibit A). This claim is based upon the action commenced in the Court of Chancery of the State of Delaware in and for New Castle County, styled Edward T. Joyce, as representative of former stockholders and warrant holders (including LaSalle option holders) of 21st Century Telecom Group, Inc. v. RCN Corporation and RCN Telecom Services of Illinois, Inc., C.A. No. 19621-NC (the “Delaware Action”). This claim seeks damages in excess of \$20 million arising from the Merger Agreement and the 10% of the purchase price (approximately \$21.24 million) held back at the time of the merger (the “10% Holdback”) for a period of one year to permit RCN to assert any indemnity claims against the 10% Holdback. Pursuant to the Merger Agreement, 21st Century shareholders would receive RCN common stock in exchange for their 21st Century stocks and warrants. Although the 10% Holdback was to be paid in RCN common stock, the calculation agreed upon for the number of such shares allowed RCN, rather than the 21st Century stockholders, to receive the benefit of the increase in RCN stock value (which was steadily rising throughout negotiation of the Merger Agreement). 21st Century stockholders were to receive more total shares of RCN if the market value of the RCN shares declined before payment of the 10% Holdback – *i.e.* the 10% Holdback was set by dollar amount, not by number of shares.

3. Claim No. 1510 asserts a general unsecured claim in the amount of \$38 million plus damages, interest, attorney’s fees and costs. Pursuant to the Merger Agreement, and agreements entered into in accordance with the Merger Agreement, the owners of 21st Century stock that was exchanged for RCN stock were to receive up to an additional \$38 million dollars

of consideration contingent on 21st Century achieving certain performance targets relating to merchantable homes passed and system revenue. The Merger Agreement provides, in words or substance, that RCN would use its best efforts to assist 21st Century to effectuate this “build out.” In order to perform the build-out, 21st Century had to acquire certain franchise licenses from the City of Chicago. 21st Century also had to purchase cable and other material to effect the build out. In the normal course of business, 21st Century should have had the franchise licenses in a matter of weeks after the Merger Agreement was signed. The necessary cables and other equipment were readily available to 21st Century. However, as confirmed by those directly responsible for obtaining the franchises and the cable and equipment on behalf of 21st Century, the superior officers of RCN instructed them to delay obtaining the franchises and withheld the funds necessary to purchase the cables and other equipment. The foregoing facts constitute breach of contract by RCN, tortious interference with a contract, breach of fiduciary duties, and fraudulent conduct by officers and directors of RCN, all to the damage of Joyce and the former 21st Century stockholders in an amount of at least \$38 million plus interest, attorney’s fees, costs and expenses.

4. On October 7, 2004, the Debtors filed their Second Omnibus Claims Objection, which seeks, among other things, to subordinate Joyce’s Claim Nos. 1509 and 1510 pursuant to section 510(b) of title 11 of the United States Code (the “Bankruptcy Code”).

5. On October 12, 2004, the Debtors filed their final Disclosure Statement with Respect to the Joint Plan of Reorganization of RCN Corporation and Certain Subsidiaries with the Joint Plan of Reorganization of RCN Corporation and Certain Subsidiaries (the Plan”) attached thereto.

RESPONSE

6. Section 510(b) of the Bankruptcy Code provides:

For the purpose of distribution under this title, a claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security, or for reimbursement or contribution allowed under section 502 on account of such a claim, shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.

7. In support of subordination of Joyce's Claim Nos. 1509 and 1510, the Debtors cite the following cases in the Second Omnibus Claims Objection: In re Granite Partners, L.P., 208 B.R. 332 (Bankr. S.D.N.Y. 1997) (subordinating investors' claims based on debtor's post-investment performance misrepresentations which allegedly induced investors to hold securities); In re PT-1 Communications, Inc., 304 B.R. 601 (Bankr. E.D.N.Y. 2004) (subordinating investors' claims based upon the debtor's failure to issue stock in exchange for investors' capital contributions); In re Kaiser Group Int'l, Inc., 260 B.R. 684 (Bankr. D. Del. 2001) (subordinating claims arising from the debtor's alleged securities fraud and material misrepresentations that induced the claim holders to enter a merger agreement). The types of claims subordinated in these cases appear to be distinguishable from Joyce's Claim Nos. 1509 and 1510.

8. In each of the cases cited by the Debtors, the investors' subordinated claims were based upon claims arising from the investors' right to share in the profits of the debtor. See Granite Partners, 208 B.R. at 336 (the investors "share the profits to the exclusion of the creditors"); Kaiser Group, 260 B.R. at 689 ("the [investors] retained the upside in any value of the Debtors' stock". See also Frankum v. International Wireless Communications Holdings, Inc. (In re International Wireless Communications Holdings, Inc.), 279 B.R. 463, 470 (D. Del. 2002)

(investors “retained the right under applicable agreements to participate in corporate profits if [the debtor] succeeded”).

9. Here, Joyce’s Claim No. 1509 of \$20 million is based upon the Merger Agreement which – although not accurately memorialized, thus giving rise to the Delaware Action – should reflect that RCN received the benefit in any upside in the RCN common stock to be used to pay the 10% Holdback. RCN negotiated for, and Joyce (and his constituents) agreed that the 10% Holdback in the approximate amount of \$21.24 million would be paid in RCN common stock valued at the end of the indemnification period (one year after the closing of the merger) so that RCN, not Joyce (and his constituents), would realize the benefit of the then rising value of RCN stock.

10. Similarly, Joyce’s Claim No. 1510 of \$38 million is based upon the improper and wrongful interference with the “build out.” Although Joyce (and his constituents) were to receive stock valued at approximately \$38 million upon satisfaction of the “build out,” the number of shares was likewise limited so that RCN , not Joyce (and his constituents) would realize the benefit of the then rising value of RCN stock.

11. Pursuant to applicable state law, Joyce’s claims may be liquidated to a monetary value.

12. Mandatory subordination pursuant to Bankruptcy Code section 510(b) “reveals a Congressional desire to shift to the shareholders the risk of fraud in the *issuance* and *sale* of a security – no more.” The Limited Partners’ Committee of Amarex, Inc. v. The Official Trade Creditors’ Committee of Amarex, Inc. (In re Amarex, Inc.), 78 B.R. 605, 609-10 (W.D. Okla. 1987) (emphasis in original). The Amarex court held that only claims based upon alleged violations of securities laws, and arising from the purchase and sale of such securities, fall within

the scope of section 510(b). Amarex, 78 B.R. at 610. All other claims – *i.e.* common law claims which arise from conduct occurring subsequent to, not arising from, the issuance and sale of the securities – are not subject to mandatory subordination. Amarex, 78 B.R. at 610.

13. Bankruptcy Code section 510(b) does not apply in every instance where a claim somehow involves the securities of a debtor. Claims based upon promissory notes made by a debtor in the context of purchasing their own securities are not subject to mandatory subordination under Bankruptcy Code section 510(b). See Montgomery Ward Holding Corp. v. Schoeberl (In re Montgomery Ward Holding Corp.), 272 B.R. 836 (Bankr. D. Del. 2001); In re Wyeth Company, 134 B.R. 920 (Bankr. W.D. Mo. 1991).

14. Assuming *arguenda* – which Joyce contests – that Joyce’s Claim Nos. 1509 and 1510 are subject to mandatory subordination under Bankruptcy Code section 510(b), the Debtors improperly seek to subordinate Joyce’s claims to the interests of RCN’s common shareholders.

15. Section 510(b) of the Bankruptcy Code clearly provides, in pertinent part, that such qualifying claims “shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority as common stock.”

16. Here, the security in question is RCN’s common stock. Nevertheless, the Debtors in their Plan propose to classify all Subordinated Claims (which term is defined to include a claim subject to subordination under section 510(b) of the Bankruptcy Code) in Class 9 and classify Equity Interests (which term is defined to include the Debtors’ common stock) in Class 8.

17. In Lernout & Hauspie Speech Products, N.V. v. Baker (In the Matter of Lernout & Hauspie Speech Products, N.V.), 264 B.R. 336, 344 (Bankr. D. Del. 2001), the court held that

the investors held stock in an affiliate of the parent and that application of section 510(b) required the subordination of the investors' claims to those of the affiliate's general unsecured creditors, "but may be treated *pari passu* for distribution purposes with other equity security holders of [the affiliate]." The Lernout & Hauspie court denied the debtors' request to subordinate the investors' claims to the level of the equity interests in the parent. Lernout & Hauspie, 264 B.R. at 343-44.

18. If the Court applies section 510(b) and subordinates Joyce's Claim Nos. 1509 and 1510, then such subordination should be limited to allow Joyce's claims to share *pari passu* with RCN's common stock holders. The subordination of Joyce's claims to the interests of RCN's common stock as the Debtors' request here exceeds the clear language of Bankruptcy Code section 510(b) and should not be permitted by the Court.

WHEREFORE, Joyce respectfully requests the Court to enter an order denying the Second Omnibus Claims Objection as it relates to Joyce's Claim Nos. 1509 and 1510 and granting Joyce any further and additional relief the Court deems just and proper.

Dated: New York, New York
November 3, 2004

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