UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK
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In the Matter
of Case No.
04-13638
RCN CORPORATION,
Debtors.
----------x
June 22, 2004
United States Custom House
One Bowling Green
New York, New York 10004

Motion to Establish Procedure for Interim Compensation and Reimbursement of Expenses; Motion to Set Bar Dates for Filing Certain Proofs of Claim; Final Hearing of Application and Entry Authorizing Retention of PricewaterhouseCoopers LLP; Final Hearing of Application and Entry Authorizing Retention of Skadden, Arps, Slate, Meagher & Flom LLP; Notice of Hearing on Authorization of the use of Lenders Cash Collateral and Granting Adequate Protection; Motion for Order Approving and Ratifying Exit Financing Commitments and Payments; Objection by U.S. Trustee to Debtors Application to Retain Skadden, Arps, Slate, Meagher & Flom LLP; Debtors' Response to U.S. Trustee's Objection.

B E F O R E:
HON. ROBERT D. DRAIN,
U.S. Bankruptcy Judge.

A P P E A R A N C E S:

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP
Attorneys for the Debtors
Four Times Square
New York, New York 10036
BY: JAY GOFFMAN, ESQ.,
FREDERICK D. MORRIS, ESQ.

MILBANK, TWEED, HADLEY & McCLOY LLP
Attorneys for Creditors' Committee
One Chase Manhattan Plaza
New York, New York 10005
BY: DENNIS F. DUNNE, ESQ.,
DEIRDRE ANN SULLIVAN, ESQ.

ANDREWS & KURTH LLP
Attorneys for Wells Fargo Company
Vulcan Ventures Inc.
450 Lexington Avenue
New York, New York 10017
BY: PETER S. GOODMAN, ESQ.,
LYNNE M. FISCHMAN UNIMAN, ESQ.

A P P E A R A N C E S (Continued):

HALPERIN & ASSOCIATES
Attorneys for NCTC
555 Madison Avenue
New York, New York 10022
BY: ROBERT D, RAICHT, ESQ.

WHITE & CASE
Attorneys for Deutsche Bank
1155 Avenue of the Americas
New York, New York 10036
BY: ANDREW P. DeNATALE, ESQ.

CAROLYN S. SCHWARTZ
UNITED STATES DEPARTMENT OF JUSTICE
OFFICE OF THE UNITED STATES TRUSTEE
33 Whitehall Street
New York, New York 10004
BY: PAUL SCHWARTZBERG, ESQ.,
of Counsel

RCN Corporation

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

THE COURT: Please be seated.

Mr. Goffman?

MR. GOFFMAN: Thank you, your Honor, and good morning. Jay Goffman Skadden Arps on behalf of the debtors. Thank you for hearing us this morning. Your Honor, of note in court today I have with me Mr. Anthony Horvath, the debtors' chief restructuring officer, as well as Mr. Sherman per rang gee, both of whom are available for testimony if necessary. We are also, however, relying on the affidavits which were filed in connection were with today's hearings at the first day hearing. Those are the affidavits of Mr. Horvath and Gorman. We think that provides an evidentiary basis for today's hearings, most of which are continued hearings of the first day. We have two adjourned matters, four uncontested matters, and three consisted matters. And if it's okay, your Honor, what I would like to do is briefly walk through those matters and deal with the orders at the end of the hearing.

THE COURT: Okay.

MR. GOFFMAN: The first two

adjourned matters are the application to retain Alix Partners. At the request of the official creditors' committee, we've adjourned that to July 1st at 10:00 a.m.. and then at the request of Wells Fargo and Vulcan, who are two shareholders, we've adjourned the final hearing with respect to the implementation of the trading procedures with respect to equity shares until July 1st also.

THE COURT: Okay. And in the meantime those procedures will stay in place on an interim basis?

MR. GOFFMAN: That's correct, your Honor. Thank you.

Then we have four uncontested maters, these are continuations from the first day. The first is the application to retain Swidler Berlin Shereff Friedman as counsel. Again, notice was served in the first day's hearing affidavits of service have been filed, and there have been no objections filed.

THE COURT: Okay. Does anyone want to address that motion?

I will grant that then on a final basis.

MR. GOFFMAN: Thank you, your Honor.

The second one is our application to retain PricewaterhouseCoopers as auditors of the debtors. The same facts are true, the notice was appropriately served, affidavits have been filed, and again, no objections have been filed.

THE COURT: Okay. Anyone have anything on this one?

I'll grant this one also on a final basis.

MR. GOFFMAN: Thank you. The next one is motion for setting bar dates. It's a very standard motion. It sets the usual set up bar dates. It's 45 days from the date that we mailed the bar date order. It provides for a publication date which we need to fill in the blanks, but which we propose to be June 30th, which is next Wednesday. It provides --

THE COURT: So that's roughly 30 days?

MR. GOFFMAN: 32 days, I believe.

THE COURT: Okay.

MR. GOFFMAN: It provides for the standard government bar date of 180 days. It

provides for a lease rejection bar date as the later of 45 days following the venue of lease rejection date or the general bar date. It is truly the standard bar date order and there were no objections filed.

THE COURT: Okay. Well, the notice periods seemed fine. I haven't talked to my clerks as to whether they have reviewed it or not, but assuming it follows the suggested local form, that sounds fine.

MR. GOFFMAN: Thank you, your Honor.

Next we have the motion for an administrative order establishing interim compensation procedures. Again, this is what we would consider a very ordinary course type order in this district. It provides for a procedure for payments on a monthly basis, provided that objections aren't filed. It provides for the usual notice to all the relevant parties, the debtor, debtors' counsel, committees, the U.S. Trustee and the banks; it provides for payments on an interim basis. It does not do away with the need for interim fee applications, and actually requires those as a condition of continuing to participate

in the process.

No objections have been filed, your Honor.

THE COURT: Okay. Based on my review of that, it appears to be in the standard form, and I'll approve it.

MR. GOFFMAN: Thank you, your Honor.

That brings us to the three contested matters for today, each of which have one objection.

The first is our motion for a final order on the use of cash collateral. Again, this was approved on an interim basis at the first day hearing. Since that day, there have been some extensive negotiations between the committee, the debtor, and the bank agent. There have been some changes to the interim order to reflect those negotiations, and we have a black line version. The two main changes are that the administrative agent has dropped its request for replacement liens on the avoidance actions, and the final order now provides that the reporting requirements that are deliverable to the administrative agent will also be delivered to the committee in the same format

and at the same time.

We received one objection that's from a party which we will call NCTC the National Cable Television Cooperative. That's a company that RCN has a contract with, and they provide cable programming to RCN subsidiaries. We are in compliance with that contract, we are current on that contract, they are not a current creditor of the creditor of the debtor, and they certainly were not as of the petition date.

The principal objections, as we can tell from what we've read and from what we've learned from talking to them is that they would have liked to have seen a specific line item in our budget for their payment. They also would like us to provide some sort of carveout in the DIP order to give them adequate assurance, as if they were a secured creditor. Well, they are not a secured creditor, your Honor, they are just a simple contract holder, like any other party. We have a contract with them, we are in compliance, and we intend to stay in compliance; whatever their rights are, they are. If they have administrative claims because we do business with them on a post petition

basis, we will pay them in the ordinary course and stay in compliance. In fact, we told them they are in the budget. The operating companies make the payments to them in the ordinary course. But RCN, the entire company is a very large company, and we don't have separate line items for every single party that we do business with. They have identified 3.8 million is the amount that they think they are owed on a monthly basis. We've in fact allocated in our budget more than that to that particular item and we've told them so because it may vary from month to month. But, no, we don't have a specific line item in our budget.

They also raised questions about whether or not there is essentially some sort of administrative insolvency at the parent level. First of all, there's no basis for raising that in this context, but there is no administrative insolvency. RCN is part of the overall RCN entity. They have a centralized cash management system. There is plenty of cash to cover the needs. The operating subsidiaries pay their obligations in the ordinary course. Frankly, there is no basis for the objection. I think that's -- the reason we are

having a little bit of difficulty in struggling and responding to the objection, is because when we asked them to please cite to us a code, section or any law in support of their position, they couldn't do so. They know they are not a secured creditor, they know there's no law in support of it, so basically they say that they have gotten something like this in on some of the cases so they want it, and that's not a good enough basis to come in and object to cash collateral. There is no basis for their objection, they are not a secured creditor, we are in compliance with their agreement. We ask that you overrule their objection and approve the use of the cash collateral in the terms we've entered.

THE COURT: Okay. Why don't I hear from NCTC.

MR. RAICHT: Good morning, your Honor. Robert Raicht from law firm of Halperin and Associates. We are co counsel to NCTC.

As was set forth, we are a cooperative that represents over a thousand independent cable operators, and the purpose of the coop is to be able to provide companies like RCN

with the ability to get volume discounts, which we are able to get by negotiating directly with networks. RCN is a coop member and is a party to a member agreement which existed as of the filing date. In leading up to today's hearing, we had inquired, given the fact that we have performed under this agreement postpetition and we believe it's clearly RCN's intention that we continue to do so postpetition, to give us some reasonable assurance that we are not simply going to be performing services for which we will never get paid. And we have been told that we are in the budget, but if you look at the budget, I fail to find a line item that I could arguably put my client's anticipated future claims in, other than generalized, you know, category for operating disbursements. And given the magnitude of the burn rate between my client, which is approximately 4 thousand dollars a month, it is not by any means is an insignificant --

THE COURT: You don't mean 4 thousand.

MR. RAICHT: I'm sorry, 4 thousand might be insignificant; 4 million dollars on a

monthly basis, and that that depends on what position the debtor intends to take, which we've had some issues over in terms of how they intend to pay us in the future. We have been being prepaid prior to the petition date, and that was important to us, since when we incur services on their behalf, we in tern have that obligation to pay the networks directly. So it's a significant issue, and we thought it was a fairly straight forward question, saying to them show us where we are in this process. And other than point to a generalized vague budget that provides -- a cash collateralized facility that provides for strict adherence to a budget, a limited deviation. And I think that as we sit here today, I think we need more than just simply a statement that there's more than enough money in the budget. I think we've heard in any number of large cases where at the end of the day parties are fighting over percentages on an administrative basis.

THE COURT: Are the operating companies obligated under this agreement?

MR. RAICHT: RCN.

THE COURT: Just RCN, not the

operating company?

MR. RAICHT: That's correct. And in terms of the cash collateral facility itself, this is a facility where the lenders are taking up any and all unencumbered assets and other rights that may not be available, so what it does is it makes perfectly clear if at the of the day and the music stops and there's monies due my client, there will be absolute no unencumbered funds to pay for them, and I don't think we should be required to perform this performance in a business, as we are being asked to do. I don't think it's unreasonable, given the 4 million dollar monthly obligation that that would appear to qualify for a line item and we didn't think that was an unreasonable request, that there be an additional provision to make sure that we are providing services, if they want to go forward with it, that there is some assurance that we will be paid.

MR. GOFFMAN: Your Honor, the request that you just heard is essentially a request that every creditor that has a contract has a right to come in and demand a specific line item for their contract on a postpetition basis. That's

not what the law provides. We are in have -- we have a contract with them, we are in compliance, we intend to comply. We don't need a specific line item for every contract. No debtor ever provides a specific line item for every contract that it has on a postpetition basis. They are trying to take an unsecured prepetition contract and elevate it into a secured claim. They don't have that right. They are being paid in the ordinary course. If they think we are in breach, they would bring an action. If they think they have some sort of right they would bring on a motion. But they are coming to this court, and without citing to any law in support of its position, just saying, your Honor, we're special, we're a special contractor and we want a line item. We are different than everybody else in the world, and he we want a special line item just because we ask for it. There's nothing in the law to support that position. They are being paid, we will pay them. I'm making a representation on the record. The subsidiaries have always paid them, that's part of their obligations, and they are continuing to pay that. He's been told that, he just wants more than he's

entitled to as a matter of law. He's not entitled to be treated as a secured creditor; he's not entitled to a carveout.

THE COURT: Are you asking for a carveout?

MR. RAICHT: Well, what we are asking for is to have an express provision put in for the obligations that we know and they know, the debtors knows they intend to incur going forward.

Let me just also -- the statement that we have been paid to date is not one that I can sign onto; we actually looked into that yesterday, and I have not been able to verify that's true. In fact I've heard we have not been paid since the petition date, so I can't, you know, join in on that statement.

But, you know, this is a significant amount of money on a monthly basis, and it would be -- if we are left without some assurance, and which again they want us to perform, they want us to incur these services for them for their benefit, yet they don't want to provide us with any kind of assurance. I'm not saying security, but assurance that we will get paid at the end of the day. At

the end of the day we have other similarly situated cable operators that would be adversely affected in the event we were saddled with a significant postpetition obligation here. And there's no reason why, since we are a party to a contract, the debtor would take the position that we are required to perform, that by the time we got in there with some sort of motion, we could be holding a substantial claim at that point which there might be no ability to pay.

THE COURT: Okay. I'm going to deny this objection. It is a somewhat unusual objection to a cash collateral motion. It sounds to me that it's really not in the nature of the type of objection we would actually anticipate under the codes. It's more in the nature of an attempt to treat your client under 366, it seems to me, since you actually used the term adequate assurance, or, as would be more appropriate, to compel assumption or rejection under 365. But as an objection to the cash collateral motion, I really take it, given the unsecured nature of your client's relationship with the debtor, is simply an objection to debtor and the other parties in interest business judgment to

enter into the cash collateral stipulation. If the stipulation wouldn't approved, I think your client would be in worse shape than it is today, and less likely rather than more likely to get paid.

Mr. Goffman has represented on the record, and I take it that if this is in fact an important agreement, I'd even take some comfort in the fact that the debtor does not intend to default under it, but it has its rights under 365, just as you have your rights under 365, to make a motion to compel. And I don't think that you can use an objection to a cash collateral arrangement to, in effect, assert those rights at this point.

MR. RAICHT: May I just confer one of the representations? I think I heard Mr. Goffman say that there is provision in the budget apparently for payments to NCTC.

THE COURT: That's what I heard him say. He's not intending to make those payments forever. His clients may reject your contract at some point, but -- I see him nodding.

MR. GOFFMAN: That's correct, your Honor.

THE COURT: That when they

negotiated with the secured creditors they made provision, they took into account their continued use of the services your client provides and they made a provision in their calculations for use of that cash.

MR. RAICHT: Very well, thank you.

THE COURT: Okay. Can I see the black line?

MR. GOFFMAN: Certainly, your Honor.

I think Mr. Dunne has one thing to put on the record also.

MR. DUNNE: Your Honor, Dennis Dunne from Milbank Tweed appearing on behalf of the unsecured creditors in these cases. I was actually hoping to have resolved this before the hearing, but I don't see counsel for the agent here. I believe that there is just a ministerial error in the form of the final order and it's in paragraph 10 which is the bar date for commencing actions against prepetition secured lenders.

The interim order said that time period would be 90 days from the date of the order approving the appointment of counsel to an official committee of unsecured creditors in these Chapter

11 cases, a date which hasn't occurred yet, the 90 days hasn't run yet. The final order says September 8, 2004, which is 90 days from the appointment of the official committee. So I just believe that is a ministerial error. We haven't been able to confirm with counsel for the agent.

THE COURT: Okay. I saw that. The Southern District guidelines do contemplate running that time from the appointment of counsel.

MR. DUNNE: Counsel is here.

(Conferring)

MR. DUNNE: We will do 120 days from June 8, and without prejudice to our rights to seek other exceptions.

THE COURT: I would assume that counsel will be appointed by that 30 day extension anyway, so that's a fine resolution.

MR. GOFFMAN: May I approach?

THE COURT: Yes.

Okay. I've reviewed the black line with the one change that was just set forth on the record about the 120 days, and I'll approve it based on the record and the affidavits previously submitted.

MR. GOFFMAN: Thank you very much, your Honor.

That brings us to our motion for an order authorizing, approving and ratifying the exit financing commitments and the related expenses.

This motion was also filed on June 4, 2004, as authorized by the court at the first day hearing on June 2nd. That was served on 18 day's notice rather than on 20 day's notice. Again, one objection was filed, and that was by Wells Fargo and Company and Vulcan Ventures by Andrews and Kurth. And I'll note that Andrews and Kurth was present on that day when your Honor authorized us to serve it on 18 day's notice.

The only objection to this financing, and I think your Honor, if I may, in order to understand this motion and the need for it, we need a little bit of history. First, before we do, we need -- when I read the objection, a few things jump out at me. The objection basically says the motion is grossly premature, there's really no benefit to the estate from approving it now, the shareholders here are somehow being prejudiced because they assert it's a sub rosa

plan, and that this really isn't a commitment of any kind. The facts show that they're wrong on every single count. When you look back at the history here, you have to go back about nine months ago when we actually started the restructuring negotiations; you have to go back to last September 2003.

Vulcan has always been a significant party in interest in RCN. Vulcan is an investment vehicle for Mr. Paul Alan. Mr. Alan, as everyone knows, is one of the wealthiest men in the world; he is one of the original founders of Microsoft. He was good enough to have invested several years ago approximately 1.25 billion dollars into RCN and had gotten preferred shares for that. He had his representatives sit on the board of directors and got all information at all times. Back last September when we began the restructuring negotiations with the banks and the bondholders, Merrill Lynch was the financial advisor for the company, and through Merrill Lynch and the other company representatives, one of the key parties that the company approached in trying to put together a plan was Vulcan and Mr. Alan. We have a

great deal of respect for Mr. Alan, and we respect the investments that he's made in this company over the course of the years. Visits were made to him and his people out in Portland, he was provided with all relevant information; he was asked time and time again in which way he might want to participate in the process. Ultimately, at some point in the fall, the company was advised that Vulcan did not want to participate in the restructuring process, that Vulcan's representatives were stepping off of the board, that they did not want to receive any further information from the company because they did not want to be restricted any further. They had apparently made a determination that, for whatever reason, that their shares did not have value, and that they wanted to take for their own tax reasons --

MR. GOODMAN: Your Honor, Peter Goodman on behalf of Vulcan Ventures. None of this is mentioned in any of the pleadings or the affidavit, this whole history. I'm here on behalf of Vulcan Ventures here today. As I understand the debtors' basis for its motion today is in its

business judgment, that the court should approve the exit facility at this time, and we argue it's premature. So I think all these hearsay statements regarding what Vulcan said to RCN, and what RCN said to Vulcan is somewhat irrelevant to the basis for the motion to certify the debtors.

THE COURT: Well, Mr. Goffman, were you involved in the process under which Vulcan was solicited for its interest of whether it wanted to do some sort of new money investment or pursue other alternatives than what is being sought today which is exit financing?

MR. GOFFMAN: Yes, I was. I was counsel at the time, so I'm personally aware of the discussions, the entreaties and all the process. Mr. Goodman may not be aware of it because he may be new to the process, but I'm aware of the of all the facts, and since he put in his papers that they had no involvement, that they've been kept out of it, and have not had the ability to participate in the process, I think it's important for the court to know that the facts are otherwise.

THE COURT: Okay. Well, I'm less interested in what Mr. Alan chose not to do, or

more particularly his reasons for not choosing it than to hear what the debtors have considered in the process leading up to this motion, other alternatives, including a sale, including a stand alone funding financing from existing parties in interest.

MR. GOFFMAN: Certainly. Let me come to that then. So as we move through the fall, we continued with the negotiations with our banks and bondholders. And the difficult part we had was that all parties recognized that the banks, the company, the bondholders, the members of the board, and the equity holders that we talked to, basically all recognized that the total enterprise value of the company was far below the total amount of the debt, that there really was no equity value. And so it was obvious to everyone that we needed the bonds converted all to equity. But that wasn't going to be sufficient to make this restructuring work, because in order to really give this company a chance to choose success coming out, we needed to fix the capital structure beyond that. We needed the bank debt to have better terms, a longer amortization schedule, a longer maturity, and just

generally better terms.

We negotiated that many, many months, but unfortunately we were having a great deal of difficulty in reaching a consensual resolution with the banks on reaching that type of longer maturity and a longer amortization schedule. With that in hand, it was also very difficult to get the bondholders to agree to convert the debt to equity and come to the prearranged plan. That lead us to the point where fortunately Mr. Duvel and Blackstone were brought in as new advisors, we were able to move down this different path. With their hope help, we began on the process of trying to bring in new financing. The market was for new financing was very strong, so Blackstone and the company, lead by Mr. Duvel, moved down the path of seeking out the best new financing we could get to replace the existing financing. And we sought out all potential new financing possibilities. We talked to at least 11 different new lenders, narrowed it down to seven, eventually narrowed down to what we all call our final four. Our final four included Deutsche Bank, who ended up winning, it included Wells Fargo, and included two other major

name players.

MR. GOODMAN: Your Honor, I just want to clear the record because this is the second time I've heard this. I've had the opportunity now to speak to my client and review Mr. Goffman's papers on this point. The entity that he states in his reply papers that was interested in providing exit financing is Wells Fargo Foothill Capital. We represent Wells Fargo and Co., the bank that's holding the securities. They may be affiliated but they are separate corporate entities first of all. I discussed this with my client, he had no knowledge of this, first of all the allegations that Mr. Goffman has made about Wells Fargo bidding on the exit financing. Secondly, he mentioned to me that the bank does have walls that are put up to preserve the confidentiality, not only the separate entities, but of the separate investments.

MR. GOFFMAN: Okay. Be that as it may, Wells Fargo Foothill was one of the four final bidders. We went through the process and in the end we chose Deutsche Bank, because we believe, and the banks believe, and the bond holders believe, that the Deutsche Bank facility provided this

company with the best opportunity to for restructuring this company in a consensual manner. It's at a minimum a seven year facility that provides enough money to repay the entire existing JP Morgan facility and provide the liquidity needed to move forward. It's on excellent terms, the best market terms that we could get after talking to everyone, and it was the firmest commitment we could come up with. It is the lynchpin for this restructuring. It is the single key factor here. It is that -- that is the single factor upon which our existing bank group is willing to work with us on providing cash collateral. It is the single factor upon which our bond holders are willing to convert theirs 1.1 billion dollars of their debt into equity and not require any take back debt or any other restrictions. It is the single key factor to get this restructuring done.

Given that, once we got that into place, the other elements of restructuring fell into place nicely. So obviously, when all this was brought to the company and the board, it became a reasonable and rationale business judgment for the company to make the decision to go forward with the

Deutsche Bank financing and to seek the approval of it. We are seeking the approval of the necessary terms to lock in this financing. This financing is the firmest financing we could come up with. It is the best one we could get after doing an entire market analysis and talking to all the major lenders that were out there, including the affiliate of Wells Fargo bank.

Your Honor, when you have a situation where everyone has participated, you've gotten your best financing, that financing is the lynchpin for the success of the restructuring. Then the question is are we in any way infringing upon or impairing their rights. They suggest we are, or they suggest this is somehow a sub rosa plan. Well, it's not. If they are right, if there's really equity value here above and beyond what anybody else believes exists, they are going to have the right to prove it. We are going to come here, we are going to bring in a plan, we are going to stand here with all our experts, and we are going to present our evidence as to what we think the equity value of this reorganized company is. If they can come in and show we're all wrong

and that there's more equity value, they are going to get it. All this financing is doing is creating a structure for this company to be able to reorganize on better terms. It creates more value. That value can only help them, it can't hurt them. So nothing that's being sought today is harming them, it's just creating an ability for this company to reorganize and still creating the opportunity for them to come in and prove that they can, that there's more value than anyone else thinks exists.

They have had the right to participate, this isn't premature. This is the end of a long and lengthy restructuring process, it is the lynchpin for this restructuring, it is absolutely necessary to get the restructuring done, their rights are fully preserved, it is essential to getting this restructuring completed, and what we are seeking here is completely within sound and rational business judgment with this debtor.

With due respect, Your Honor, we ask that you approve the motion.

THE COURT: Let me just ask you a couple of questions.

If approve by me, expires year end, December 31, 2004; is that correct?

MR. GOFFMAN: That's correct, your Honor, but they have the ability to extend.

THE COURT: Right. And I saw something in here about a default or termination if there's not 118 million of free cash on a consolidated basis, was I reading that right, at confirmation?

MR. GOFFMAN: May I, your Honor?

THE COURT: Sure.

(Counsel and witness confer)

MR. GOFFMAN: There's a requirement for minimum cash balance at closing of 115 million dollars, but the debtor is comfortable that is well within our budget.

THE COURT: That was going to be my next question.

MR. GOFFMAN: Yes.

THE COURT: Okay. And again, as I read the term sheets and the commitment letter, I didn't see a requirement that the plan have any particular treatment, other than of course the fact that there's a debt limitation coming out on the

company, but there's no particular treatment of any individual creditors; is that correct?

MR. GOFFMAN: That's correct, but this is not a sub rosa plan, your Honor.

THE COURT: Okay. Does anyone want to speak in favor of this financing before Mr. Goodman?

MR. DUNNE: Your Honor Dennis Dunne again on behalf of the committee. I'm not going to repeat what Mr. Goffman had to say, but let me just give you the thoughts from the perspective of the official committee, as well as those members of it who served on the ad hoc committee prepetition and intimately involved with the process. I probably have three specific responses before a general comments. The first is that the test ultimately is a business judgment, and the official committee has no doubt that the debtors have met that. The company, together with its advisor, Blackstone, canvassed the market. They created a spirited competitive environment and the economic terms that we have before the court today are the product of that competitive environment and product of numerous rounds of bidding, and Blackstone

literally bidding one player over the other to get the lowest economic terms for the creditor agreement, as well as the lowest fees and the most favorable conditions proceeding to closing. So from my perspective, from a process standpoint alone, your Honor, this deal turns out to be market. We would all love to have lower fees, we would all love to have better rates and longer maturities, and that being said, at the end of the day, the market dictates what's fair and reasonable. And I think the process here evidences that, particularly since at the time that we were in a very high capital market and there was a lot of interest in doing the syndicated loan.

Second, your Honor, I want to just focus on one of the alternatives that we were looking at a few months ago, which was to do a stand alone plan with the preexisting bank group staying in place under a consensual plan of reorganization. We were pretty far down the road on that deal, and the terms of that were significantly more onerous than what we have in front of us. There was a shorter maturity rate, and this was particularly important to bond

holders, there was amortization requirements of upwards of a hundred million dollars in the first few years post closing of restructuring that would literally stress this company's business plan and the feasibility, in the short term, of the plan. One of the key benefits to the Deutsche Bank facility is minimal amount of amortization in the short term, as well as a longer maturity date; their maturity date for the term loan is seven years, for instance, on the BP it's seven and a half years.

Lastly, your Honor, I want to focus on the Mack. The Mack was the subject of bidding, and Deutsche Bank had the most favorable one and others were much tighter. The Mack in this document focuses on financing markets and material efforts, changes in the general economic conditions of the financial markets, and was better than the other bidders were willing to do. Lastly, your Honor, this is not a sub rosa plan. The equity will have their chance to show at confirmation that the values are such that they should be entitled to a recovery here. I personally believe that that's a tough task for them for at least two reasons, one

of which is that the bondholders would have preferred to have put on some debt on this company. But as your Honor pointed out, the commitment letters were conditioned on certain leverage ratios, which is typical in these situations. And those leverage ratios dictate what they dictate and as a result we have an all equity plan going to the bond holders. And on a related points, that all equity plan has been disclosed to the world, your Honor, it's been the subject of a press release. All the bondholders who buy and sell out there today know they are the future owners under this plan, if it's confirmed under 1129, of a hundred percent of the common stock of reorganized RCN. The bonds are currently trading, your Honor, at 60 cents on the dollar, and there is a billion one of bonds outstanding. There are over 400 million dollars of missing value, if you will, before the preferred stockholders are in the money.

My final point, your Honor, is that this is not premature. We are basically eight months into a year long restructuring. I think it's unfair and inaccurate to describe this restructuring as only weeks old; the Chapter 11

cases may be, but the restructuring process is not. The cases are clear that bankruptcy courts favor out of court workouts and prearranged deals, because they facilitate cheaper on more successful reorganizations of Chapter 11 entities. And that is precisely where we are now, your Honor, this is, as Mr. Goffman said, a cornerstone of the restructuring and the official committee supports the motion.

THE COURT: Okay. Mr. Goodman?

MR. GOODMAN: Thank you, your Honor.

Your Honor, Peter Goodman on behalf of Vulcan Ventures, Inc. and Wells Fargo and Co., substantial holders of the debtors' series B preferred stock.

THE COURT: Is Vulcan Ventures, Inc. controlled by Mr. Alan or someone else?

MR. GOODMAN: Mr. Alan, it's my understanding, is the controlling interest holder in the ventures.

THE COURT: Okay.

MR. GOODMAN: Your Honor, it is the position of Wells Fargo and Vulcan Ventures that the business judgment does not apply to this exit

financing. Under the terms of the exit facility, the burden of the exit facility, that is the fees and expenses are incurred today during the course of a Chapter 11 case, but the benefits of the funding are contingent upon a plan of reorganization and confirmation order being entered. Accordingly, it is our belief that Section 1129 of the Bankruptcy Code and the plan confirmation requirements must apply to approval of an exit facility such as this.

Now, the debtors have admitted in their pleadings that it is unusual to ask for exit financing so early in a case, a case that is only weeks old, not even a month. And in fact, the debtor has no support for entering into an exit facility at such a early date. The debtor does cite to an order that was entered in Delaware in the Onico case. Onico Investments was different, that was a DIP facility where the debtor was getting benefits under the facility and was to be converted to an exit facility on confirmation of a plan. The debtors also cite to Allegheny International. Allegheny International is a very old case that goes back to my early days of

practicing as an attorney. That was a very troubled case that lasted for many years. The exit facility was not entered into at the beginning of the case, and the exit facility, at least from my review of the case, did not provide the terms of a plan of reorganization.

THE COURT: But what about all the cases that approve sales of substantially all the assets of a company, the closing of which is contingent upon the confirmation of a plan, such as Global Crossing, the one I just had in Allegiance, XO Communications, isn't it really the same point?

MR. GOODMAN: I don't believe so, your Honor, because in those cases what's being provided to the debtors is proceeds, proceeds from a sale, and is subject to, I believe, a break up fee, which the debtor cites to the break up fee cases all involve assets sales. And in those instances courts approve break up fees, because there is a purchaser who is coming in and is willing to provide consideration to the debtors. It is purchasing the assets, which is different from what we have here. We have an exit facility that's going to be put in place. We are replacing

one facility with another facility that will be a post confirmation facility. So there is no direct and immediate benefit that is being provided to --

THE COURT: Well, these sales don't provide a directly and immediate benefit other than giving the debtor and creditors confidence that they have, if they confirm a plan, the ability to receive proceeds. Isn't that the same as --

MR. GOODMAN: I understand.

THE COURT: -- as this facility, in that the creditors know that if the plan is confirmed they have the ability to receive these proceeds?

MR. GOODMAN: Well, there is a difference here, your Honor. The difference is, in those cases, first of all, they are, as I understand the facts, the debtors are entering into an asset purchase agreement conditioned upon confirmation of a plan of reorganization. So at the very least you have the 1129 requirements which protect creditors, protect shareholders in interest, with respect to that type of asset sale. There are also sales, and clearly there are many sales where substantially all the assets are sold

preconfirmation. In those cases there is case law in the Second Circuit, there is the Lyonel Standards in those cases. There is precedent for the sale of asset prior to confirmation if certain requirements under the Lyonel Standard articulated by the Second Circuit is met.

I don't believe that there is any precedent, at least case law, that is cited which is analogous to this decision which locks, okay, locks the debtor into a plan. And the reason we believe it locks the debtor into a plan is because it states in the motion itself what all creditors are going to receive and what the equity holders are going to receive, which is minimal and diluted distribution under their current plan of reorganization.

Now, as far as the exit facility is concerned, we are told that it's not dictating a plan, but in fact a plan is proposed in the exit facility motion. In addition, the debtors disclose, on page four of their reply, that the exit financing commitments contain market terms that would exist in any exit financing proposal and merely reflect the reality that no lender will

obligate itself to fund a plan that is not acceptable to it; so here the lender has some veto power over the plan. Now what Mr. Goffman says is that, well, at the time of confirmation if we have a valuation fight and its determined that equity should be entitled to more of the reorganized value of the company, then the plan provides for it. Well, first of all, in the motion it doesn't state that. Second of all, we believe that since the lender has a veto power, the plan has to be acceptable to it, it puts an impermissible thumb on the scale of what the plan should be, and an impermissible thumb on the scale of the 1129 requirements. There is nothing that I've seen in the facility which states that, for example, if your Honor decides that there is a more appropriate allocation of reorganized value of the company, that that would be acceptable to the banks. So the banks, at least according to the debtors' reply on page four, does have veto power in this instance.

THE COURT: Well, if the leverage ratios are the same, that your clients get say five percent of the equity or 20 percent or even 50 percent of the equity, wouldn't it be unreasonable

for the bank to -- for Deutsche Bank to withhold consent to that plan since they already negotiated those leverage ratios?

MR. GOODMAN: It may or may not I don't know what the conditions are of the bank's acceptance hear. It just says in the reply papers that no lender will obligate itself to fund a plan that is unacceptable to it. And what we are approving here is something that is within the bank's sole discretion as opposed to a reasonableness standard where your Honor can intervene as an arbiter of what is reasonable, I think have that is categorically different.

Now, we don't believe that the exit facility is a firm commitment. The exit facility provides for a market out provision. It excuses the commitment if there's an adverse change to the syndication market or capital markets. Now, in the provision that we have seen with respect to this market out, which is in the commitment letter, the banks have no obligation to go out into the market -- affirmative obligation, and syndicate the loan. In fact, they are left with the discretionary standard, again, that if they believe

there is an adverse change in the market they don't have to go out and syndicate.

In addition, your Honor, we believe that the fees are excessive. What we're doing here today in effect is approving the debtors entering into this commitment and incurring fees and costs. Now, we have not seen the fee letter. The fee letter has been filed under seal so all we are left with is a description of the terms of the fees that is contained in the motion and the commitment letter, and I believe a separate escrow letter. By our calculations, the fees are in excess of 3 percent if you add them together in the aggregate. There is a 4.6 million dollars in termination fees, if the facility is terminated. We believe that that is unusual. This is one percent -- this is the one percent termination fee, that is one percent of the face value of the loan. There is also a break up fee of 6.9 million dollars if the debtors receive other financing or if the debtors enter into a similar restructuring transaction. There is no definition here of what is meant by a similar restructuring transaction. For example, an interested investor may be willing to invest a

substantial portion of the debtors' reorganization needs through an equity investment. Is that going to trigger the break up fee? There is also a commitment fee of 2.3 million dollars, a non refundable work fee of 250 thousand. The exit financing may also not be required in the event there is a sale of the company. Despite what Mr. Goffman said, my understanding from discussion with Vulcan and with Wells Fargo, is there's been no discussion with those two entities concerning the allocation of equity in this case under the debtors' proposed current exit financing facility, none at all.

So in sum, your Honor, I think it is premature to enter into this exit facility. By the debtors' own admission, it's unusual to enter into an exit facility at this time. I believe that with respect to asset sales where there's been historical practice and the safeguards that have been implemented by the Second Circuit in the Lyonel Standard which has been refined by other case law which involves sales out of the ordinary course of business or sales that we have through a plan of reorganization are markedly different than

what we have here. I also believe that the break up fee cases, all of the break up fee cases that are cited to by the debtors are in the asset sale context where the debtor is to receive proceeds from the sale of its assets and not really what is tantamount to the replacement of one facility with another.

I believe that the fees are excessive, I think they are duplicative, there is a termination fee there is a break up fee which the implementation of the break up fee -- excuse me, the payment of the break up fee, when it may be incurred by the estate, is not clearly defined. And we do believe that this is a sub rosa plan, that by definition an exit facility is not going to benefit the estate until a plan is confirmed. I'm not saying that an exit facility -- exit facilities are not entered into closer to confirmation of a plan of reorganization, because I know we have all seen that. But I think at this early stage of the case, particularly one which seems locked into a certain plan of reorganization that was negotiated prebankruptcy without the participation of all the parties in interest, is premature and should not be

approved by the court.

THE COURT: When you say it's locked in, you are referring to the description in the motion, not the commitment letter itself?

MR. GOODMAN: I am -- what I am talking about is the description that has been in the exit financing motion and several other pleadings filed by the debtors in this case, and by the debtors' statement that a plan has to be acceptable to the lenders and does not seem to carve out the notion that the allocation of the reorganized value of the company, if your Honor decides there should be a different allocation, that the banks at that point aren't required to lend.

THE COURT: Okay.

MR. GOODMAN: Thank you.

MR. GOFFMAN: Very briefly, your Honor.

Your Honor has it exactly right. This is no different than any of the sale cases where a sale is conditioned upon a plan confirmation. There are real benefits to be gained here, and Mr. Goodman's attempt to separate this

from those cases is a good attempt, but it doesn't really get anywhere. Clearly this isn't a sub rosa plan. And again, if they can prove there's equity value, they would be entitled to the equity. All the Deutsche Bank commitment does is set up a limitation on debt. If they can prove there's more equity value so that the bondholders aren't entitled to one hundred percent of it and there's some additional value for the preferred shareholders then they would get it. All that provision meant in the motion was that there was only a certain amount of debt coming out of this restructuring on the company, and that's the provision in the Deutsche Bank commitment.

As to whether or not the terms are market terms or whether or not the fees are low enough, or whether or not he's happy with them, Mr. Goodman's speculation as to whether or not the fees should be higher or lower or whether or not the terms are better or worse has nothing to do with what the market is. We conducted an action process, a fair, full and complete one, and came up with the best terms that we could. As to the speculation as to whether or not a shareholder may

want to participate, well, we've been asking for nine months. If they wanted to participate, they had the opportunity. They can't blow up the restructuring at the last second just because he wants to stand up at the podium and speculate again that somebody may want to participate.

All the factors that justify support the Deutsche Bank financing today have been satisfied. It is within the debtors' business judgment. There's plenty of case law to support it, and I would ask that your Honor approve it.

THE COURT: Okay. All right.

I have in front of me a motion for approval of an exit financing facility in related fees and expenses by its definition. The implementation of the facility is contingent upon confirmation of a Chapter 11 plan, but approval is being sought at this point because the negotiation of the facility is the result of a lengthy process, is a several months process, which culminated after competitive bidding in the particular facility that's before the court at this point. And one of the terms of the facility requires court approval in advance of the outline of the facility and the

fees and expenses. And secondly, it's being sought at this point because it will provide direction and guidance to the debtors and the creditors in the confirmation of a plan. The facility is actively supported by the debtors' unsecured creditors' committee, many members of which were involved in the prepetition process that resulted in the negotiation of this particular facility; and there have been no objections to the request, other than an objection by Vulcan and Wells Fargo. Wells Fargo is a fairly recent entrant into the restructuring process, but Vulcan has been involved as a shareholder, having made an extremely significant investment in the company some time ago.

I'll grant the motion but deny the objection for the following reasons: First of all, the applicable statutory section for approval at this point is Section 363(b) of the Bankruptcy Code primarily, although Section 364 as incorporated by 1123 will come into play at the time of confirmation. Section 363(b) is a particularly flexible section of the Code that requires ultimately however, the bankruptcy court, if there

is an objection, to review and consider the merits of the proposed action out of the ordinary course.

The debtor and the committee have urged me to use the -- apply the business judgment standard here. The Vulcan and Wells Fargo objectants said that that standard shouldn't be applied, and that one should apply the plan confirmation standards, in effect to delay this motion until a plan is actually teed up and voted on and subject to confirmation. I believe that the proper standard to apply here is the 363(B) business judgment standard, in that this motion, while it does provide, as I said, a context of guidance for a plan, does not dictate a plan any more than the sale of substantially all of the assets preconfirmation would dictate a plan. And as we all know, that type of relief is well recognized in the Second Circuit and elsewhere.

The business judgment standard actually is a little different than as the debtors' stated it in their reply to the objection, at least as I read it and as articulated by the Second Circuit in Orion. Ironically, it is the bankruptcy judge's business judgment that is supposed to be

applied here. Although, before everyone gasps at that prospect, the bankruptcy judges and district judges in this district have been quick to, in the proper circumstances, defer in large part to the debtors' business judgment, particularly where the creditors' committee and the majority of the parties in interest support that judgment. And particularly, as is the case here, where the action that's being proposed to be taken by the debtor was the result of a competitive market driven bidding process, which I take from Mr. Coleman's affidavit as well as the representations by Mr. Dunne and Mr. Goffman, who were also both involved in that process, resulted, in effect, in an auction among four competing lenders.

The objection states first that this is being sought to expedite a schedule. I do not believe that to be the case. As I just said, I think this is a result of a lengthy process, and the debtors and their creditors should not be penalized because the bulk of that process occurred prepetition. Secondly, the objection states that the specific terms of the proposed financing as well as the fees are too high and inappropriate;

however, the objectants have not sought to cross examine the Blackstone investment bankers who were involved in the process or provide independent proof as to why the fees that resulted from that competitive process are not market as a result of the competitive bidding that occurred at that time. I give more credence to the objection about the fees going to the termination fee, and more particular, the break up fee set forth in the fee letter. However, I believe that while most, if not all of the case law in this circuit, is in the context of sale break up fees. I do not believe that that case law confines the court's approval to sale break up fees, particularly where such a large amount of cash is being committed and where the lender is clearly subject to the contingency of a confirmed plan for the transaction to close. I believe that a break up fee here of 1.5 percent, and as defined in the fee letter, one that is triggered by a transaction like this one being given, notwithstanding the auction to another party besides Deutsche Bank, is in fact appropriate. As far as the termination fee and the other fees provided for and expenses provided for, I deem them

as market driven.

The third objection is that the commitment is not really a commitment that it did not affirm, because there is a material adverse effect out as well as market and syndication outs; however, based on my review of those provisions, as well as the process that was undertaken to result in this proposal being chosen as the winning proposal, I view those provisions as fairly innocuous, and I would expect that Deutsche Bank would exercise its rights under those provisions only in a very highly unusual situation, particularly given the non bankruptcy case law on such provisions, and I note that I would have jurisdiction over any dispute as to the assertion of rights under those provisions.

This leaves the last objection which I briefly dealt with earlier, which is that according to the objectants, the financing commitment is a sub rosa plan, and therefore not susceptible to approval under Section 363(d) of the Code. I think that there's a meaningful distinction between recognizing that, in a context of a debtors' restructuring, this proposal is, in

Mr. Goffman's words, a lynchpin for moving forward in the plan process; that there's a meaningful distinction between that and a sub rosa plan. Any debtor that moves along in a bankruptcy case, and in this case during the lengthy pre bankruptcy period, has to make decisions that affect the course of the restructuring. It has to decide, for example, whether to pursue a sale process, whether to approve a stand alone restructuring, whether to pursue a new money proposal, for example, from someone like Mr. Alan. It can't keep all of its options open forever or else it would never restructure, and its in that context that the debtor is pursuing this proposal. It still has the option, however, under this proposal, to pursue a sale, to pursue a proposal, for example, where Mr. Alan would put new money into the company and the like. But in order to lock in this option, which it and its creditors have decided is the best one to pursue, it would have to pay some money, some real money to Deutsche Bank to change course at the end of the day. But that's just the price of narrowing down its options. What this option does not do is dictate the terms of the specific plan;

most importantly, it does not dictate the amount of shares that the unsecured creditors will receive. Mr. Goodman pointed out that Deutsche Bank does have the discretion to withhold exit financing if the form of the plan is not acceptable to it; however, Deutsche Bank, like any contracting party, is bound by the obligation of good faith and fair dealing, and particularly in the context of a bankruptcy case, it would not be good faith, in my mind, and it would not be in Deutsche bank's own interest, since it is not an unsecured creditor here, a prepetition unsecured creditor, to withhold approval of a plan that maintains the same leverage ratios that it's negotiated simply because a group of bond holders is not receiving a hundred percent of the equity but rather is receiving, for example, 95 percent of the equity and 5 percent of the equity is going to the preferred shareholders. So I do not believe that the lenders veto power to the extent it is a legal power, it would dictate that type of plan treatment. And again, as I said, although one would have to pay termination fees if the debtor was to pursue, for example, a sale, if one came in after all of these months that was

better than this deal, it does have that flexibility to do so, and that type of fee has been approved and is without, I think, dispute, appropriate in this circuit.

So, I view this as an appropriate exercise of business judgment and I'll approve it on that basis.

MR. GOFFMAN: Thank you very much, your Honor.

That brings us to our final motion this morning, that being the motion to approve the retention of Skadden Arps as bankruptcy counsel to the debtors.

This motion was filed and served in accordance with our first day hearings, and only one objection was filed, and that was by the U.S. Trustee. As your Honor may recall, when you left the court that day, I honestly believed that we had reached an understanding with the U.S. Trustee. It was on that basis that I had filed a revised affidavit the next day, or day or two later, that provided for additional detail regarding Deutsche Bank and JP Morgan. Unfortunately, I was mistaken, we did not have an understanding, and therefore the

U.S. Trustee has filed an objection which they filed Friday. We filed our response and served it yesterday, and that brings us to today.

The sole basis for the U.S. trustee's objection, your Honor, is that we have a U.S. Trustee now in this district that wishes to impose a new rule; to unilaterally impose what we'll call the 1 percent rule. And what that is is that the U.S. Trustee has taken the position that any time debtors' counsel has a client, that when you affiliate that client with all its other affiliates, if that affiliate group is a party in interest in the Chapter 11 case, if that group affiliate client represents more than one percent the firm's revenue during the year, they represent that it disqualifies, or you have to bring conflicts counsel to deal with that party regardless of whether or not there's any actual conflict, without any specific analysis, without looking at any facts at all. It is a per se rule that's being sought by the new U.S. Trustee.

In their objection they do not suggest, nor could they, that there's any actual conflict. As we make clear in our response, the

U.S. trustee's position is completely inconsistent with the Bankruptcy Code, the bankruptcy rules, the legislative history. All the case in this circuit, all the cases cited in their own objection; frankly every case that's ever addressed this issue is inconsistent. There has never been a single case anywhere that's ever followed this so called one percent per se rule. In Aerochem, which is a Second Circuit Court of Appeals decision addressing this issue, the court made clear its draconian measure to disqualify counsel. It can only be done on a case specific basis, and only after a very fact specific analysis. And that's what the cases in our response said; frankly, that's what the cases in the trustee's brief said. The trustee cites the cases supposedly in support of its position, but they don't support its position. It talks about Leslie Faye and cites some dicta. Well, Leslie Faye is a well known case from this district. In Leslie Faye what you had was a situation where debtor's counsel failed to disclose the fact that it had a conflict which could have impaired an investigation into facts that -- about the debtors' management which precipitated the

Chapter 11 case. Notwithstanding those types of egregious facts, bankruptcy counsel didn't disqualify the debtor. The bank court said no, there's a balance here. It's important here that the debtor get the capital that it needs. There are balance and facts, and what the court said is even under those egregious facts it said interest are not considered adverse merely because it is possible to conceive a set of circumstances under which they might clash, and they let the debtors law firm stay in tact; and that was a case where there were these actual conflicts. And similarly, the U.S. trustee cited TWI International. Again, it supported its position. But again, the bankruptcy court in this district said, "merely hypothesizing the that conflicts may arise is not a sufficient basis to warrant the disqualification of an attorney, and that disqualification should be mandated when an actual, as opposed to a hypothetical or theoretical, conflicts is present."

Your Honor, we can walk through every single case in their objection. Every single one points to a different conclusion than they are cited for. Every single one stands for the

proposition that you can only disqualify or force conflicts counsel on a fact specific basis, not per se rule. You have to look at the facts and determine whether there is an actual conflict or potential conflict serious enough that it outweighs the harm that's caused by bringing conflicts counsel. So the question is where does this 1 percent law come from? It's clearly not in the Bankruptcy Code, it's not in the rules, and it's not in the legislative history. It doesn't exist anywhere. The U.S. Trustee is making it up and seeking to impose it on counsel in this case and counsel in all other cases.

Now we are not suggesting that conflicts counsel should never exist. We would be the first to suggest that if there were a conflict there should be conflicts counsel. We wouldn't wait for the U.S. Trustee to tell us. If there were a situation where there was some alleged impropriety and the party were a client and we had a conflict, we would have brought it in long before the Chapter 11 filed a conflicts counsel. As your Honor has the Parmalat case, a perfect example of a situation where conflicts counsel makes sense. The

key parties are alleged to have done something wrong significantly that caused the Chapter 11 filing. The debtor's counsel has a significant client relationship with them. They shouldn't be the one investigating that relationship; you bring in conflicts counsel. You do a fact specific analysis and you determine whether conflicts counsel are appropriate, and if so you bring them in. We said that. And as we said, we always identify who are our large creditors so we can then begin the analysis to determine whether or not there's a real conflict and if so bring in conflicts counsel.

In this particular case everybody admits there is no conflict. No one suggests there is any issue with JP Morgan, no one suggests there is any issue by with Deutsche Bank, there's no alleged impropriety, there's no issues with security, there's no issues of any kind. Nevertheless, to dissuade any concerns, we've gone out and gotten explicit waivers from Deutsche Bank and JP Morgan for the purpose of this case to make it clear that we can negotiate with them on all areas. We have never represented JP Morgan Chase

or Deutsche Bank in connection with RCN, and we will not do so at all during these cases, so there can be no concern about that.

If any issues ever were to arise that a conflict appeared, we know our duties. We know if an issue ever arose, we would immediately bring it to the company's attention, the court's attention, and bring in conflicts counsel. We've already lined those people up just in case, and they would be brought in immediately, so there's no issue. The cases make clear that you bring in conflicts counsel or you disqualify debtor's counsel when there's a good factual reason to do so. You don't just impose a 1 percent rule. The bankruptcy Code doesn't say that, and frankly there's a good reason it doesn't say that. Congress, in its infinite wisdom, didn't write it that way, because if you had the one percent rule you could never practice bankruptcy law. If that were the rule in this district you could not file any more major cases here. If that were the case, we as a firm could never negotiate with any of the secured lenders in any case; DIP financing, exit financing, cash collateral, plans, disclosure

statements. In this particular case, not only can't we do it, but committee counsel can't do it either. They wouldn't be allowed to talk to the banks. This would be a very quiet case, Judge. According to the U.S. Trustee, nobody can talk to anybody. So this prearrange plan that we negotiated nine months completely falls apart. We can't go out there and do a road show to finish our exit financing, we can't go out and finish our creditor agreement; we can't do anything do any of the things we need to do to finish this. Because is there a conflict? No, there's no conflict. Just because the U.S. Trustee wants to impose a per se rule that's not supported by the Bankruptcy Code or any case anywhere.

With due respect to everyone in this courtroom, we think it's a dangerous rule; we don't think it's supported by the law and we would ask that your Honor to overrule the objection and approve our retention.

THE COURT: Let me ask you, what is the basis for Skadden's statement that JP Morgan only holds five percent of the bank debt? Is that based on what?

MR. GOFFMAN: They represented that to us in writing. They give us a list, everybody that's in the bank group and who holds what, and it includes what they hold.

THE COURT: Okay.

MR. GOFFMAN: So they have given that to us in writing.

THE COURT: Okay.

Does anyone want to say anything before I hear from Mr. Schwartzberg?

MR. DUNNE: The committee has a position on the application.

THE COURT: Okay.

MR. DUNNE: Your Honor, I'll be brief. I think Mr. Goffman hit all the points. The committee does support the application and the retention of Skadden. The committee does take seriously the requirements of disinterestedness and Section 327, as well as its duty to review any application to ensure compliance of this. And while the hypothetical that the U.S. Trustee raises is remote, it's potentially real. We were just talking about it in a prior hearing. What if there's a dispute with Deutsche Bank for failing to

fund or for needing its right to approve any plan more broadly than anyone in the courtroom believes it should. In that scenario we may actually have a conflict, and I think there's agreement among all the parties here that in that scenario that Skadden could not represent the debtors' estate in connection with that litigation; they would have to bring in conflicts counsel.

What we are talking about simply is whether that hypothetical prevents them from doing work with respect to Deutsche Bank today; and we don't believe that that's the law. First of all, Skadden has disclosed its representation of Deutsche Bank, so we are all aware of it. We can all monitor it to determine if and when it becomes an issue. Mr. Goffman said he would alert the court and the appropriate parties in interest if the conflict has become manifest. And I believe Skadden does that at its peril if they fail to timely alert the other parties. I simply think there's no basis for accelerating a remote hypothetical to reveal unpresent conflicts which would have defective severing what we are hoping would be a seamless transition in a prearranged

deal from an out of the court dialogue into an in court. And when you look at the work that's been done -- with Deutsche Bank we already have a commitment letter, your Honor just approved the commitment letter. What we are talking about is documenting the terms that have already been agreed upon, and the principal economic terms and the covenants, et cetera, have, for the most part, been agreed upon. It would make no sense, in committee's view, to bring to conflicts to document the deal which is consensual right now, fully negotiated in terms of a commitment letter, and over which Skadden has extensive knowledge. The committee believes it would create a needless and expensive layer of additional administrative expense costs to bring in conflicts counsel now to address a perceived but highly unlikely hypothetical. And the same is true, your Honor, with JP Morgan in the sense that there the cash collateral order was just approved on a final basis today. We are all marching towards a world where JP Morgan and the prepetition bank group is taken out with the Deutsche Bank commitment letter and there should be very little for to Skadden and the

debtors to do on that except replacing the 13 week budgets as they run off with new ones and to bring in conflicts counsel to deal with the cash collateral order, and that kind of maintenance work doesn't make sense to the committee, again, with the caveat that if there ever is a dispute with JP Morgan Chase Skadden could not handle that.

And with that, unless your Honor has any questions, the committee supports the retention of Skadden Arps.

THE COURT: Okay.

MR. SCHWARTZBERG: Good morning, your Honor. Paul Schwartzberg from the U.S. Trustee's office.

First, your Honor, I think Mr. Goffman misread my objection and misunderstood our arguments or discussions prior to the filing of our objection, regarding our objection. We are not articulating a one percent rule and we are not articulating a per se rule. Mr. Goffman indicates that what our rule is if an attorney representing a debtor has a client in the case on the other side that over generates over 1 percent of its revenue, and the client is a party in interest, that

attorney or the law firm for the debtor is disqualified. That is not what we are saying, and I don't necessarily disagree with what Mr. Goffman said, but that's not what we are saying.

First of all, we do not have a one percent rule. We use it as a guideline to determine whether the attorney or counsel for the debtor has an interest or has a relationship with a party in the case and then we look and see what that party is. In this instance and in this case, when we looked at the facts of this case and we did a case specific analysis, we looked at the two parties, the two creditors that Mr. Goffman's law firm, Skadden Arps, has a relationship which generates over one percent of their income, and they are Deutsche Bank and JP Morgan. Deutsche Bank, your Honor, is not only is a potential provider of exit financing, it is, as Mr. Goffman said, the lynchpin to this case. So we are not talking about a party in interest as Mr. Goffman's brief and Mr. Goffman's statements were, we are talking about the lynchpin of the case. The lynchpin of the case is a client that generates over one percent of Skadden's revenues. It is a

significant client, and I would only guess that it's a client that generates tens of millions if not greater than that revenue of the firm.

So when we are talking about negotiating the exit financing which is the lynchpin of the case, we are talking about Skadden representing the debtor as well as having on the side a client that generates significant income for Skadden. Second, what we are talking about here is not, once again, a party in interest, but is a major player in this case; it's JP Morgan. JP Morgan isn't just solely the creditor or secured creditor, but it's the lead bank in the -- or the agent bank in the prepetition financing. And on top of that, and I'm not sure this doesn't necessarily cause an actual conflict, they are also, I believe, the funder of Skadden's financing for its expansion of its own office space; and according to Skadden it's not an issue, but on supplemental disclosure it turned out Skadden owes over 27 million dollars under a lending agreement which JP Morgan, I think, or I believe is acting as the agent.

So we are we are not talking about

any party in interest in this case, your Honor, we are talking about a fact specific case study where we are looking at Skadden's representation of the parties in interest, and we are then looking at who those parties in interest are and how they play out in the case and how they play or whether they are significant clients of Skadden or not.

Your Honor, Mr. Goffman also spoke about waivers. I just wanted to touch briefly on that. The waiver is between the attorney and the client, and that might be, outside of bankruptcy, sufficient to get rid of any disqualifying factors, but we are talking about a bankruptcy case here. And when you are dealing with a bankruptcy case, you are dealing with not only the two parties to the waiver, but all the creditors and other people in interest who are not part of that waiver. And in fact, the American Printers case which I cited in my brief discusses this issue and indicates how in the non bankruptcy setting, waiver may be appropriate, but in bankruptcy cases scenario they are not and do not and get rid of disqualifying factors.

Your Honor, although Mr. Goffman

talks about also there being no actual conflict, I do posit the fact that JP Morgan is a -- or Skadden is a creditor of JP Morgan -- vice versa, because of the financing that JP Morgan provided to Skadden. There is case law, and there's significant case law that talks about an appearances of impropriety and actual conflicts, and potential conflicts, and how the potential conflicts and the appearance issues can cause the disqualification of a law firm. We cited cases in our brief regarding that, the Premier Farms case, and cases of the like where the court did not point to a particular actual conflict, but noted that the secured creditor was a significant client of the law firm and the appearance issues arose to the fact that the law firm should not be granted to continue to represent the debtor.

Also, your Honor, in Mr. Goffman's reply, although not stated orally, they attached a significant amount of memorandum from other cases, briefs filed in other cases, applications for retention, but none of those are case law. And they are just -- they don't have any precedential value in the Morgan Trust Realty case, 123 B.R. 626

specifically says that the court wants to make law that it would right write an opinion, and as I indicated and I think our brief indicated, there are cases out there that show appearances of impropriety, which is what basically we are talking about here, or the potential of a conflict could be a disqualifying factor.

THE COURT: I didn't spend any time with the attachments because I didn't know whether they were litigated or not, so you should assume that I'm not relying on those.

MR. SCHWARTZBERG: So at sum, your Honor, we are not asking the court to bless or put -- set forth a one percent rule, what we are seeking here is to have a realization that if you have a significant client in the case, and that client happens to be, as Mr. Goffman says, the lynchpin in the case, and you have another client that's the lead bank on the prepetition lending, and that client had a significant -- and that client has also lent you money, that there is an issue here where one can look at it and say you have Skadden on one side and a significant client on the other side, and you have an appearance of

impropriety that and can lead to disqualification or that Skadden get conflicts counsel. And as indicated in their brief, Skadden realizes there may be some issue and that they've gone out and gotten special counsel rather than conflicts counsel, but someone sitting on the wing to step in.

THE COURT: Okay.

MR. GOFFMAN: Just very briefly, your Honor. We would refer your Honor to the Marvel decision, the Third Circuit Court of Appeals, and Dynemark petitions cited in our briefs. We think both of those decisions are on point and are correctly cited. We think they make it absolutely crystal clear that in a context such as this where the facts match exactly, where there's no actual conflict, where there is just this hypothetical, that you should not disqualify counsel from bringing in conflicts counsel. And without getting into it too much, regardless of what was said here or said in the brief, we were clearly told by the U.S. Trustee that there is -- they were seeking our disqualification on a per se 1 percent basis. We asked them to look into the

facts, because we told them that there was no actual conflict of any kind. And we were told they are not going to look into the facts; one percent, that's it, conflicts counsel or be disqualified. Those are the facts. They can say what they want. We ask your Honor to approve our retention.

MR. SCHWARTZBERG: Your Honor, I would like to rebuff Mr. Goffman's one statement. I think it can be said that it's categorically incorrect and he mischaracterizes it. I'm not saying he didn't hear what he just said, but we didn't say that there is a one percent rule.

And if Mr. Goffman has any questioned about it, I'll say now, Mr. Goffman we don't have a one percent rule. We look at the facts of the case and we use 1 percent as a guideline, and I'm not disputing that that's what was heard but that's what was said.

MR. GOFFMAN: Yes, that is what I heard.

THE COURT: Okay. I am going to approve the application in and deny the objection, although, I want to say right off the bat that I believe that the U.S. Trustee's analyses here and

approach here is well taken. I think that where there is a combination of factors like this, where you do have a client that, at least on paper, appears to be playing a large role in a case, and that client provides is significant amount of revenue, a bell should go off. And it doesn't hurt, I think, to have that issue raised in front of the court so the court and the other parties can pay the type of attention that needs to be paid to that situation. Whether it's one percent or one and a half percent or .75 percent, clearly with a firm as successful as Skadden, one percent is a lot of money, and I would rather focus on a lot of money than with a particular percentage. But one percent here is a lot of money.

Now that being said, I'm denying the objection and granting the application because I think that and find that when one looks at the facts as they actually are here, notwithstanding the fact that both JP Morgan and Deutsche Bank provide a lot of revenue to Skadden. Their role in the case as it exists now, and as I find likely will be the case through the duration of this Chapter 11, is not one that is likely to put

Skadden in a conflict position where there is an actual conflict. And in the unlikely event that an actual conflict arises or there is a real potential for an actual conflict, Skadden has acknowledged, as it needs to obviously, that it would at that point bring in conflicts counsel.

The U.S. Trustee does not differ from Skadden on the applicable standard, which is, as enunciated by the Second Circuit in Aerochem, requires the court to do a fact based case by case analysis of whether there is a real adverse interest, and that's what I've done here. As far as Deutsche Bank is concerned, I think Mr. Dunne got it right, the main negotiating with Deutsche Bank occurred prepetition. And the implementation of that deal, which is pretty heavily documented in the detailed term sheet and the detailed fee letters, we've had a hearing on the financing just prior to this hearing, all layout where the parties should go. And in balancing the interest here, it seems pretty clear to me that it would be quite detrimental to the estate and the creditors to replace Skadden at this point with conflicts counsel to finish the negotiations with Deutsche

Bank. And the detriment to the estate of doing that at this point I think very much outweighs the potential for an appearance of impropriety, given that debtor, I believe, the likelihood of any actual conflict arising is small.

That of course leaves aside the whole issue which I found remarkably undiscussed in the case law as to whether one should aggregate the affiliate clients in any event. Skadden makes the point that the particular Deutsche Bank entity that is the lender here is not a client of Skadden, but I'm not really relying on that, because I believe there may be situations where one should consider affiliate relationships in a conflict area, and we really haven't gotten into that issue here in any factual way as to how much of a special purpose entity the particular lender is here or not. So I'm not really basing my decision on that but rather simply on an analysis of the likelihood that Skadden would be placed in a position where an actual conflict would arise.

As to JP Morgan, it obviously plays a significant role in the debtors' case, although perhaps not so significant in the debtors' capital

structure, given that it holds only a little less than five percent of the secured debt. But again, if one digs under the surface, it appears that it will be quite unlikely here that JP Morgan and Skadden will be in a conflicting position. The result of the prepetition negotiations, which were lengthy and heated and involved an active bondholders group which now in large measure sits on the creditors' committee, has lead to an understanding at least among the parties, that JP Morgan's bank group is over secured and in all likelihood will be paid out in full or receive the indubitable equivalent of their collateral. So when one looks at the rule of conflict that Skadden might get into in this case, it appears to me that it won't be with JP Morgan.

Moreover, the cash collateral arrangement that I've approved, as is often the case, leaves it up to the creditors' committee and its counsel in any event to challenge the bank's liens and claims, if there is to be a challenge. So that takes that issue separately out of Skadden's bailiwick and puts it in the creditors' bailiwick. So I don't find that there is, at this

So, again, I do not believe that there's a per se disqualification here. I don't hear the U.S. Trustee articulating that point

either. And I don't find that the facts justify disqualification. Obviously Skadden faces the risk as the case moves along, that if it fails to disclose or act upon an actual conflicts if one arises, that it may be disqualified or may suffer the consequences on its fees, but that's not occurred to date, and I don't find a reasonable likelihood or even a pretty remote likelihood that that will happen in the future.

On the last point, just for the record, it's disclosed and undisputed that JP Morgan is a lender to Skadden; however, there's no suggestion that that loan presents any issues whereby Skadden would have to make any concession to JP Morgan because JP Morgan is its lender, and that is the loan is not in default, and there's no suggestion that it's likely to be in default or have to be renegotiated, so I view that as, based on this record, in effect, a done deal, and it would be improper of JP Morgan to use it as a basis for putting any pressure on Skadden, and I don't believe that JP Morgan would do so.

The last point I want to make is that I do want to say something as to the waivers.

Mr. Schwartzberg is right that in a post filing in a bankruptcy environment a waiver is not conclusive. However here, where Skadden received waivers prepetition which enabled it to negotiate with JP Morgan and Deutsche Bank in an unfettered way, I think that the estate and the creditors should not be deprived of the fruit of those negotiations by requiring new counsel to come in and in effect reinvent the wheel or even subject the estate to the possibility that either JP Morgan or Deutsche Bank will simply, if you will, remember the negotiations differently and consequently put new counsel at a disadvantage. So that history of the negotiations should be preserved for the estates' benefit. And in that sense the waivers are meaningful.

So you can submit an order on that application, as well as the orders on the financing and the other matters that were uncontested.

MR. GOFFMAN: Thank you very much, your Honor.

MR. SCHWARTZBERG: Thank you, your Honor.

MR. DUNNE: Thank you, your Honor.

C E R T I F I C A T E

STATE OF NEW YORK }
} ss.:
COUNTY OF WESTCHESTER }

I, Denise Nowak, a Shorthand Reporter and Notary Public within and for the State of New York, do hereby certify:

That I reported the proceedings in the within entitled matter, and that the within transcript is a true record of such proceedings.

I further certify that I am not related, by blood or marriage, to any of the parties in this matter and that I am in no way interested in the outcome of this matter.

IN WITNESS WHEREOF, I have hereunto set my hand this _____ day of _____, 2004.

_____

DENISE NOWAK