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Hearing Date: March 3, 2005 at 10:00 a.m.

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

OBJECTION OF OFFICIAL COMMITTEE OF UNSECURED CREDITORS TO APPLICATION BY AP SERVICES, LLC FOR APPROVAL AND PAYMENT OF CONTINGENT SUCCESS FEE

TO THE HONORABLE ROBERT D. DRAIN,
UNITED STATES BANKRUPTCY JUDGE:

The Official Committee of Unsecured Creditors (the "Committee")[1] of RCN Corporation and its affiliated debtors and debtors in possession (collectively, the "Debtors") hereby objects to the application of AP Services, LLC for approval and payment of the contingent success fee, dated February 4, 2005 (the "Application"), and respectfully represents as follows:

[1] Pursuant to the Joint Plan of Reorganization of RCN Corporation and Certain Subsidiaries confirmed on December 8, 2004 (the "Plan"), the Committee continues in existence to, among other things, "interpose and prosecute objections to Professional Claims" (as defined in the Plan). See Section XIV.O of the Plan.

Background

1. In anticipation of the Debtors' filing for bankruptcy protection, AP Services, LLC ("APS") negotiated an engagement letter setting forth the terms of their proposed future retention in these cases (this letter, as amended, and as attached to the Application as Exhibit C, the "Engagement Letter"). Among other things, the Engagement Letter provided for the payment of (a) hourly rates for the services of APS's employees, and (b) a "Success Fee" triggered by certain milestones achieved in the bankruptcy cases. Specifically, the Engagement Letter provides for a $4 million Success Fee in the event that the Plan is confirmed prior to February 15, 2005.

2. However, when the Debtors requested this Court's approval of the terms of APS's retention, upon the objection of the Committee, the Court declined to approve the Success Fee. Indeed, the Court's final order authorizing APS's retention (the "Final Order") specifically stated that "all references to the 'Contingent Success Fee' in the engagement letter and the Application shall be deemed stricken." See Final Order (attached to the Application as Exhibit B) at ¶ 3.

3. The Final Order does allow APS to ***request*** a "success or similar fee" in its final fee application, but specifically provides that the Court's authorization to retain APS creates no presumption with respect to granting or denying such request. The Final Order also provides that all objections to such an application would be preserved. See Final Order at ¶ 4.

4. Against this backdrop, the Application requests the payment of the $4 million Success Fee (a sum greater than all of the fees incurred by APS during these chapter 11 cases), citing the terms of the Engagement Letter as sole and sufficient

justification for its entitlement to such fee as if this aspect of the Engagement Letter had been approved by the Court and as if the Engagement Letter was controlling or even relevant. No attempt is made to provide any other justification for APS's alleged entitlement to a success fee, let alone a $4 million success fee.[2] The Committee respectfully submits that the Application should be denied in its entirety.

Objection

5. The Application stresses the fact that APS is "neither a law firm nor an accounting firm," but rather a type of firm ("such as turnaround firms, management restructure consulting firms, and investment banking firms") that has a different compensation model, where "performance fees are normal parts of compensation." See Application at ¶ 8.

6. Indeed, the Committee acknowledges that different types of professional firms traditionally have different compensation models. On the one hand, law firms and accounting firms are usually compensated on an hourly basis, and fee enhancements for these types of professionals are extremely rare rather than the rule. On the other hand, investment bankers and similar financial advisors are usually compensated on the basis of a flat monthly or quarterly retainer plus an agreed-upon fee enhancement tied to specific targets. See, e.g., In re Drexel Burnham Lambert Group, Inc., 133 B.R. 13, 25 (Bankr. S.D.N.Y. 1991) (discussing these two compensation models). However, APS wants to cherrypick the best components of both compensation models, without the downside of either. Rather than agree to a flat retainer and take the

[2] In addition to the Success Fee, by a separate application, APS is requesting final approval of over $3.5 million in fees. APS also received payments of approximately $2.8 million for work performed prior to the Petition Date.

risk that the actual hours expended will not be fully compensated by a flat fee, but with the potential for a success fee if certain goals are obtained, APS chose to be compensated on an hourly basis (like lawyers and accountants, for whom success fees are a rare exception). It has taken no risk that its hours spent on this case are not adequately compensated. Nevertheless, they expect a success fee as a matter of course. Whatever the propriety of such a structure generally, the Committee respectfully submits that such compensation structure is not warranted by the facts of these cases.

7. Once APS elected to be compensated on an hourly basis, it implicitly agreed to the Court's review of the reasonableness of its compensation requests based on the same criteria as the Court would use to assess compensation requests of other bankruptcy professionals that are compensated on the same basis.[3]

8. Such criteria are well established. To determine the reasonableness of compensation sought by the "hourly" professionals, the courts use the lodestar amount, i.e., the number of hours reasonably expended multiplied by a reasonable hourly rate. There is a "strong presumption" that payment of the bankruptcy professional's standard hourly rates constitutes "reasonable compensation." Meronk v. Arter & Hadden, LLP (In re Meronk), 249 B.R. 208, 213 (9th Cir. BAP 2000), aff'd, 2001 WL 1563694 (9th Cir. Dec. 6, 2001) . Overcoming this strong presumption requires "specific" and "powerful" evidence demonstrating both that the results achieved in the case were extraordinary (i.e., beyond all original expectations), that the professional in question was instrumental in obtaining such results, and that such results "were not

[3] The principles for compensation of financial advisors are no different than those for the compensation of other bankruptcy professionals. See, e.g., Drexel, 133 B.R. at 24 ("Much of what we have said about [reasonableness of compensation of] attorneys and accountants is applicable to investment bankers/advisors.")

reflected in either [the professional's] standard hourly rate or the number of hours allowed." Id.

9. Because the lodestar amount already reflects (a) the novelty and complexity of the issues, (b) the special skill and experience of the professional, (c) the quality of its services, and (d) the results obtained, these factors normally cannot serve as bases for increasing compensation awards above the lodestar amount. See, e.g., Pennsylvania v. Delaware Valley Citizens' Council for Clean Air, 478 U.S. 546, 566 (1986); Houlihan Lokey Howard & Zukin Capital v. Unsecured Creditors' Liquidating Trust (In re Commercial Fin. Servs., Inc.), 298 B.R. 733, 747-48 (10th Cir. BAP 2003); Novelly v. Palans (In re Apex Oil Co.), 960 F.2d 728, 731-732 (8th Cir. 1992); Burgess v. Klenske (In re Manoa Fin. Co.), 853 F.2d 687, 690 (9th Cir. 1988); In re Ames Dept. Stores, Inc. Debenture Litigation, 835 F. Supp. 147, 150 (S.D.N.Y. 1993); In re McLean Indus., Inc., 88 B.R. 36, 39-40 (Bankr. S.D.N.Y.). The professional that "contracts at a standard hourly rate is obliged to perform to the best of [its] ability and to produce the best possible results commensurate with [the professional's] skill and the client's interests. Thus, when an award is made for all hours charged and at [the professional's] full hourly rate, there is 'very little room for enhancing the award' . . . ." Meronk, 249 B.R. at 213 (quoting Pennsylvania v. Delaware Valley).

10. The Committee acknowledges that, in a proper case, enhancements to the hourly-based lodestar compensation are permissible. However, they require "close scrutiny," Drexel, 133 B.R. at 27, and are normally reserved for those few cases that are "rare and exceptional," where "extraordinary" circumstances have resulted in the hourly rates failing to fairly compensate the professional, and where the result of the case

"exceeded the reasonable expectations of the parties." See In re Nucentrix Broadband Networks, Inc., 314 B.R. 574, 578 (Bankr. N.D. Tex. 2004) (and all cases cited therein). See also In re Gillett Holdings, Inc., 137 B.R. 452, 459 (Bankr. D. Colo. 1991) (success fees should be awarded only based on such criteria as "exceptional performance, extraordinary or unexpected benefit conferred on creditors of the estate, unusually effective and successful nature of Chapter 11 proceedings, and time frame within which such successful results are accomplished"). The professional seeking such enhancement "must do more than establish outstanding service and results. The applicant also must establish that the quality of service rendered and the results obtained were superior to what one reasonably should expect in light of the hourly rates charged and the number of hours expended." Apex Oil, 960 F.2d at 732.

11. APS has not attempted to meet its high burden of proof by providing evidence with respect to either the "extraordinary" or "unexpected" results of this chapter 11 case or its own crucial role in achieving such results.[4] The Application's sole "justification" for APS's alleged entitlement to the Success Fee is the statement that "[p]erformance fees are a normal part of compensation for firms" such as APS, and that "[t]herefore, this Court should approve" the Success Fee. See Application at ¶ 12. The Declaration of John S. Dubel filed in support of the Application fails to provide any such support other than the conclusory statement that "[t]the services of APS were important to the effective administration of the estate and recovery of value to certain parties in interest . . [and] were essential in preparing, negotiating and receiving confirmation" of

[4] In all the cases cited by APS in the Application regarding the compensation of bankruptcy professionals, the professional in question did, indeed, provide such evidence, and the relevant court specifically found such evidence to be sufficient.

the Plan. See Dubel Declaration at ¶ 4. Without more, such a statement does not justify a success fee.

Success Fee Not Warranted On Facts of this Case

12. The Committee submits that, on the facts of these cases, APS cannot meet its burden even if it attempted to supplement its Application at the hearing.

13. First, most of the terms of the Plan had been finalized prior to APS's retention, including a commitment for an Exit Facility from Deutsche Bank. Moreover, given that the Plan provided for a simple debt-for-equity swap, minimal negotiation was involved, and no particular sophistication or expertise was required to have such plan finalized and confirmed.

14. Second, the results achieved in these cases were neither extraordinary nor unexpected.[5] While it is true that these cases required substantial efforts to secure exit financing and the consummation of the Plan, it was another of the Debtors' advisors, the Blackstone Group L.P. ("Blackstone"), that had arranged such financing.[6] Moreover, the most difficult part of the exit financing – the last-out, second lien tranche -- was provided by bondholders. Again, APS played no role in this aspect of these cases.

15. Third, even in the areas of operational restructuring and cost cutting measures, for which APS was specifically retained, its performance will be

[5] Some courts have found that all creditors of the estate must be paid in full before allowing a success fee in addition to the payment of hourly rates to a bankruptcy professional. See, e.g., In re Morris Plan Co. of Iowa, 100 B.R. 451, 454 (Bankr. N.D. Iowa 1989); In re D.W.G.K. Restaurants, 106 B.R. 194, 197 (Bankr. S.D. Cal. 1989).

[6] Blackstone also seeks a success fee, to which the Committee does not object.

sufficiently compensated by the payment of its hourly rates and, in this case, does not warrant an additional success fee. The Committee expected to receive timely and detailed analyses of the Debtors' operations and contractual relationships necessary to quantify achievable cost-cutting measures as well as the potential benefits of filing additional operating subsidiaries. To obtain these analyses, the Committee asked its own financial advisors, Capital & Technology Advisors LLC ("CTA"), to expend significantly more time on these issues than was originally anticipated. While significant cost-cuts were achieved in the chapter 11 case (as is common in most bankruptcy cases given the unique opportunity to reject and renegotiate contracts and leases), the reorganized Debtors are currently dealing with various items that were not resolved during the case. As an example, APS was specifically asked to negotiate a favorable termination of a lease of an office building in New York City, which, while vacant as of the Petition Date, was costing the estate over $1.6 million a year. Despite months of efforts to negotiate such lease termination during the pendency of these cases without success, the reorganized Debtors are devoting significant time to resolving these and other issues.

16. Moreover, while APS originally was retained by the Debtors to manage the restructuring and operations of the company, in August, the Debtors felt it necessary to retain PDA Group, LLC as an operations expert. See Order Under 11 U.S.C. §§ 105 and 363(b) Authorizing The Retention of PDA Group, LLC To Perform Consulting Services For RCN Corporation, dated September 8, 2004 (Docket No. 207) (authorizing the retention of PDA Group, LLC on terms set out in the engagement letter, dated August 19, 2004). A success fee for APS is not warranted on this record.[7]

[7] To the extent the Court so desires, the Committee is prepared to present evidence on the issues set forth in this Objection at the hearing on the Application.

17. Finally, when more than one professional claims responsibility for the results achieved in a particular case, the court should bear this in mind as well, and adjust the compensation awards accordingly. See, e.g., In re Burlington Motor Holdings, Inc., 217 B.R. 711, 715 (Bankr. D. Del. 1997). Here, at least three firms have taken credit (and seek to be rewarded) for the less than spectacular results achieved in these cases: in addition to APS, Blackstone is seeking a success fee of $7.8 million (which, having been previously negotiated and approved, is likely to be allowed), and the Debtors' prepetition financial advisor, Merrill Lynch, Pierce & Smith, Inc., has filed a proof of claim claiming that it is entitled to a $9.8 million restructuring fee.

WHEREFORE, the Committee respectfully requests that the Application be denied in its entirety.

Dated: New York, New York
February 28, 2005

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