UNITED STATES BANKRUPTCY COURT SOUTHERN DISTRICT OF NEW YORK	**HEARING DATE: June 22, 2004** **HEARING TIME: 10:00 a.m.**
In re RCN CORPORATION, et al., Debtors.	Case No. 04-13638 (RDD) Chapter 11 (Jointly Administered)

OBJECTION OF THE UNITED STATES TRUSTEE TO APPLICATION AUTHORIZING RETENTION OF SKADDEN ARPS SLATE MEAGHER & FLOM, LLP

TO THE HONORABLE ROBERT D. DRAIN, BANKRUPTCY JUDGE:

The United States Trustee for the Southern District of New York (the "United States Trustee") submits the following objection to the Debtors' application (the "Application") to retain Skadden Arps Slate Meagher & Flom, LLP ("Skadden") as bankruptcy counsel. In support of her objection, the United States Trustee respectfully represents and alleges as follows:

Introduction

Two of Skadden's major clients are significant parties-in-interest in these cases and have interests which are adverse to the Debtors. Skadden's representation of J.P. Morgan Chase Bank ("JP Morgan"), the agent bank for, and lender under, the Debtors' pre-petition secured credit facility, and its affiliate group generates over 1% of Skadden's annual revenue. In addition, Skadden itself borrowed funds from a facility under which JP Morgan is both the administrative agent and a lender.

Furthermore, Skadden's representation of Deutsche Bank AG Cayman Islands Branch and Deutsche Bank Securities, Inc. (together "Deutsche Bank"), entities which will provide $460 million of exit financing to the Debtors, and their affiliate group also generates over 1% of Skadden's revenue. Skadden will clearly need to deal with these entities regarding matters which include the use of cash collateral, plan treatment, and consummating the exit financing, among others. Skadden may also need to sue Deutsche Bank if Deutsche Bank seeks to renege on its commitments to provide exit financing. In such situations, Skadden clients will be on both sides of the table. Skadden, therefore, represents interests adverse to the estate. Accordingly, the Application should be denied. In the alternative, the order authorizing the Debtors' retention of Skadden should require the employment of conflicts counsel to handle all matters which directly involve either JP Morgan or Deutsche Bank.

Background

1. In June 1999, prior to the commencement of these cases, the Debtors (excluding RLH Property Corporation and RCN Finance, LLC) and certain non-debtor affiliates each as either a borrower or guarantor entered into a $1 billion senior secured credit facility (the "Pre-Petition Facility") with JP Morgan as administrative agent, collateral agent and lender. Application

at 5. As of April 30, 2004, approximately $432.5 million was outstanding under the Pre-Petition Facility. Id.

2. On May 27, 2004 (the "Petition Date"), the Debtors filed voluntary petitions under Chapter 11 of the Bankruptcy Code. The Debtors have continued in possession of their businesses.

3. On June 10, 2004, an official committee of unsecured creditors (the "Committee") was appointed. The Committee has not yet moved to retain counsel.

4. On the Petition Date, the Debtors filed, among other pleadings, the Application seeking Skadden's retention.

5. On June 3, 2004, the Court entered an interim order authorizing the Debtors' retention of Skadden. A final hearing on the Application is scheduled for June 22, 2004.

6. On June 4, 2004, the Debtors filed a motion (the "Exit Financing Motion") seeking approval and ratification of the Debtors' acceptance of exit financing commitments between the Debtors and Deutsche Bank. According to the Exit Financing Motion, the Debtors have negotiated with Deutsche Bank to provide up to $460 million in exit financing to replace the Pre-Petition Facility. Exit Financing Motion at 16. Deutsche Bank has agreed to fund fully the exit financing. Id. at 15. However, it is contemplated that Deutsche Bank will syndicate the exit financing. Id. at 20.

7. According to both the affidavit of Jay M. Goffman in support of the Application (the "Goffman Affidavit") and the revised affidavit of Jay M. Goffman in support of the Application (the "Revised Goffman Affidavit"), Skadden represents interests adverse to the Debtors' estates. Specifically, the Goffman Affidavit discloses that both JP Morgan and Deutsche Bank AG are major client's of Skadden and accounted for more than 1% of the value of the time billed to client matters for the year ending December 31, 2003. Goffman Affidavit at 24.

8. After the United States Trustee met with Skadden to discuss whether Skadden's representation of JP Morgan and Deutsche Bank was a disqualifying conflict, Skadden filed the Revised Goffman Affidavit. The Revised Goffman Affidavit attempts to minimize Skadden's representation of JP Morgan Chase and Deutsche Bank. However, it does not lessen the United States Trustee's concerns.

9. Specifically, according to the Revised Goffman Affidavit, although JP Morgan Chase and its affiliate group accounted for more than 1% of the value of the time billed to client matters for the year ending December 31, 2003, JP Morgan itself, the agent for and lender under the Pre-Petition Facility, did not account for more than 1% of the value of the time billed. Revised Goffman Affidavit at 25-26.

10. Similarly, the Revised Goffman Affidavit provides that although Deutsche Bank AG and its affiliate group accounted for more than 1% of the value of the time billed to client matters for the year ending December 31, 2003, Deutsche Bank AG Cayman Islands Branch, the entity which has committed to provide 100% of the exit facility and which will act as agent for the proposed facility, is not a Skadden client. Id. Although Deutsche Bank Securities, Inc. is stated to be a client of Skadden, no revenue information is provided for the entity.

11. Clearly Skadden filed the Revised Goffman Affidavit in an attempt to demonstrate that the revenue generated by its representation of specific entities in the JP Morgan affiliate group and the Deutsche Bank affiliate group is below 1% of Skadden's billings and, therefore, avoid an objection by the United States Trustee or the need to engage conflicts counsel. The representation of a major creditor, however, may be a disqualifying factor even if such representation generates less than 1% of a proposed counsel's revenue. See Premier Farms, L.C., 305 B.R. 717 (Bankr. N.D. Iowa 2003)(proposed counsel disqualified where its representation of agent bank in unrelated matters generated between two-tenths and three-tenths of 1% of counsel's annual billings); In re Filene's Basement, Inc., 239 B.R. 850 (Bankr. D. Mass. 1999)(counsel disqualified where its representation of creditor suing debtor in unrelated matter

constituted 0.1% of counsel's annual billings). Moreover, Skadden cannot simply break apart one entity in an affiliated family in order to demonstrate that its representation of such an entity is trivial. Such an attempt ignores Skadden's representation of the entire affiliated family and places an impossible burden on the Court, the United States Trustee and other parties-in-interest to dissect a complex corporate structure to determine the connections between different affiliated entities (a process that the Revised Goffman Affidavit does not even attempt to begin). Moreover, if the Court were to ignore a firm's representation of an affiliated group, it would encourage the creation of meaningless shell entities by proposed counsel in order to evade the retention standards set forth in the Bankruptcy Code.

12. Finally, the Revised Goffman Affidavit discloses that Skadden borrowed funds from the Chase Manhattan Bank (now known as JP Morgan Chase) from a facility under which JP Morgan is the administrative agent and Chase Securities (now know as JP Morgan Securities) acted as arranger, to finance certain capital improvements as Skadden's offices. Id. at 8. The amount currently outstanding under the facility is approximately $27 million.

Argument

13. Section 327(a) of the Bankruptcy Code provides a two-pronged test for the retention of professionals. First, the professional for the debtor must not hold or represent an adverse interest to the bankruptcy estate. See 11 U.S.C. § 327(a). Second, the professional must be a disinterested person. Id. Section 101 of the Code defines a "disinterested person" as one who "does not have an interest materially adverse to the interest of the estate . . . by reason of any direct or indirect relationship to, connection with, or interest in, the debtor . . . or for any other reason." 11 U.S.C. § 101(14)(E).

14. Although the Bankruptcy Code does not define the term adverse interest, the District Court for the Southern District of New York has interpreted the standards governing retention of professionals under section 327(a) in TWI Int'l, Inc. v. Vanguard Oil & Service Co., 162 B.R. 672 (S.D.N.Y. 1994). In discussing the definition of disinterestedness, the TWI court found that an analysis under section 101(14)(E), which defines a disinterested person as one that does not have an interest materially adverse to the interest of the estate, raises identical considerations as the analysis posed by the first prong of the test contained in section 327(a): that the professional not represent an interest adverse to the estate. Id. at 674-75 (emphasis added) (citing Roger J. Au & Son, Inc. v. Aetna Ins. Co., 64 B.R. 600, 604

(Bankr. N.D. Ohio 1986)); see also In re Star Broadcasting, Inc., 81 B.R. 835, 838 (Bankr. D.N.J. 1988). The court in TWI adopted the definition of that term provided by the Star Broadcasting court, namely, to possess or assert any economic interest that would tend to lessen the value of the bankruptcy estate or that would create either an actual or potential dispute in which the estate is a rival claimant. TWI, 162 B.R. at 675. The TWI court's definition of the term "adverse interest" is consistent with the definition relied on in In re Roberts, 46 B.R. 815, 827 (Bankr. D. Utah 1985), aff'd in part, rv'd in part, 75 B.R. 402 (D. Utah 1987), and by other courts, see In re Codesco, 18 B.R. 997, 999 (Bankr. S.D.N.Y. 1982) ("There should be no opportunity for the exercise of conflicting interests or the appearance that dual loyalty may exist.").

15. Furthermore, the bankruptcy and district courts in the Second Circuit do not require that an actual conflict of interest exist to render counsel ineligible to represent a debtor. See In re Leslie Fay Companies, Inc., 175 B.R. 525 (Bankr. S.D.N.Y. 1994); see also TWI, 162 B.R. at 675; Codesco, 18 B.R. at 1000-01. Courts within the Second Circuit have recognized that an appearance of impropriety or an appearance of a potential conflict can, under the appropriate circumstances, be grounds for disqualification of a professional. E.g., In re Braten, 73 B.R. 896, 899 (Bankr. S.D.N.Y. 1987) (citing Sapienza v. New York

News, Inc., 481 F. Supp. 676 (S.D.N.Y. 1979); Matter of Proof of the Pudding, Inc., 3 B.R. 645, 648 (Bankr. S.D.N.Y. 1980)).

For example, in Leslie Fay, the Court stated that:

> [p]otential conflicts, no less than actual ones, can provide motives for attorneys to act in ways contrary to the best interests of their clients. Rather than worry about the potential/actual dichotomy it is more productive to ask whether a professional has 'either a meaningful incentive to act contrary to the best interests of the estate and its sundry creditors -- an incentive sufficient to place those parties at more than acceptable risk -- or the reasonable perception of one.' In re Martin, 817 F.2d at 180-81. In other words, if it is plausible that the representation of another interest may cause the debtor's attorneys to act any differently than they would without that representation, then they have a conflict and an adverse interest to the estate.

Leslie Fay, 175 B.R. at 532-33. In TWI, the district court noted that, given the parameters of sections 327(a) and 101(14):

> "[d]isqualification should be mandated when an actual, as opposed to hypothetical or theoretical, conflict is present. This in no way precludes disqualification for a potential conflict. The test is merely one of a potential actual conflict." In re Wm. J. O'Connor, 52 B.R. 892, 897 (Bankr. W.D. Okl. 1985).

162 B.R. at 675. Thus, firms which have connections that "impair the firm's ability to act with impartiality, even unconscious impartiality" should be prohibited from representing those conflicting interests, In re Envirodyne Industries, 150 B.R. 1008, 1019 (Bankr. N.D. Ill. 1993).

16. In Premier Farms, L.C., 305 B.R. 717 (Bankr. N.D. Iowa 2003), the bankruptcy court, using the aforementioned reasoning

in a factual scenario similar to the instant matter, disqualified proposed counsel for the debtor. In that case, the debtor's schedules listed Bank of America, N.A. (the "Bank") as the debtor's primary creditor with a secured claim of $67,000,000. Premier Farms 305 B.R. at 719. The Bank was the agent of a four or five bank syndicate. Id. Proposed debtor's counsel, however, represented the Bank in unrelated matters. Id. Such representation accounted for two-tenths of 1% of the firm's billings for 2003 and three-tenths of 1% for the firm's billings for 2002. Id. In holding that proposed counsel's representation of the Bank was a disqualifying conflict, the court found that proposed counsel "had a predisposition to bias in favor of Bank. Bank is a client. It has been one for at least two years." Id. at 720. The court noted that proposed counsel would have to deal with the Bank's bankruptcy counsel in matters such as adequate protection, plan treatment and stay litigation. Id. The court further stated that "there must be no concern in the minds of other creditors that Bank is receiving favored treatment from debtor because debtor's counsel represents Bank." Id. at 721. Accordingly, "[proposed counsel's] attorney-client relationship with Bank, one of the most significant, if not the most significant creditors in this case, creates a potential if not actual conflict of interest for the law firm. Such conflict should result in disqualification as counsel for the debtor-in-

possession" Id. at 721. See also In re Granite Partners, L.P., 219 B.R. 22, 29 & 36 (Bankr. S.D.N.Y. 1998)(where revenue generated by counsel's representation of client constituted 1.34% of firms total revenue over four year period, concurrent representation of debtor and client created the appearance that independent judgment and impartiality may be compromised); In re American Printers & Lithographers, Inc., 148 B.R. 862 (Bankr. N.D. Ill.)(disqualification of counsel mandated where significant client of counsel in unrelated matters is debtor's secured creditor); In re Amdura Corp., 121 B.R. 862 (Bankr. D. Colo. 1990)(counsel disqualified from representing debtor where counsel's significant client in unrelated matters was lead bank for debtors' $265,000,000 credit arrangement); Matter of Status Game Corp., 102 B.R. 19 (Bankr. D. Conn. 1989)(proposed retention of debtor's counsel denied because counsel's representation of secured creditor gave rise to appearance of conflict).

17. In the instant matter, Skadden owes $27 million under a facility for which JP Morgan is a lender and an agent. Skadden also represents both JP Morgan and Deutsche Bank in unrelated matters. The former is a secured creditor of the Debtors and the agent for the Pre-Petition Facility. The latter is set to provide the Debtors with a $460 million exit financing facility. Both of these entities represented over 1% of Skadden's gross

revenues last year[1/]. Accordingly, both JP Morgan and Deutsche Bank are significant and valuable clients of Skadden. Therefore, the concurrent representation of both the Debtors, JP Morgan and Deutsche Bank creates the appearance that Skadden's independent judgment may be compromised. Skadden will clearly need to deal with these entities regarding matters which include the use of cash collateral, plan treatment, and consummating the exit financing, among others. Skadden may also be required to take action against Deutsche Bank if Deutsche Bank seeks to renege on its commitments to provide exit financing. In such situations, Skadden clients will be on both sides of the table. This is a clear potential conflict of interest which provides a meaningful incentive for Skadden to act contrary to the best interest of the Debtors' estate. "[I]f it is plausible that the representation of another interest may cause the debtor's attorney to act differently than they would without that other representation, then they have a conflict and an interest adverse to the estate." Leslie Fay Companies, 175 B.R. at 533. Therefore, firms which have connections that "impair the firm's ability to act with impartiality, even unconscious impartiality" should be prohibited from representing those conflicting interests. Envirodyne

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[1/] As discussed in paragraph 11 above, Skadden cannot simply break apart one entity in an affiliated family in order to demonstrate that its representation of such an entity is trivial.

Industries, 150 B.R. at 1019, see also Filene's Basement, 239 B.R. at 858 (potential for a conflict and the perception that there might be a conflict constitute grounds for disqualification under Section 327).

WHEREFORE, the United States Trustee respectfully requests that the Court deny the Application and not approve the Debtors' retention of Skadden, or in the alternative, the order authorizing the Debtors' retention of Skadden should require the employment of conflicts counsel to handle all matters concerning JP Morgan and Deutsche Bank, and grant such other and further relief as the Court may deem appropriate and just.

Dated: New York, New York
June 18, 2004

Respectfully submitted,

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UNITED STATES TRUSTEE

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