

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

-----	x	Hrg. Date: April 12, 2005
	:	at 10:00 a.m.
In re	:	
	:	Chapter 11
RCN CORPORATION, <u>et al.</u> ,	:	Case No. 04-13638 (RDD)
	:	
Debtors.	:	(Jointly Administered)
	:	
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**REPLY OF SUCCESS FEE APPLICANT, AP SERVICES, LLC,
TO OBJECTION OF UNSECURED CREDITORS' COMMITTEE**

Success fee applicant AP Services, LLC (“APS”) hereby replies to the objection of the Unsecured Creditors’ Committee (“UCC”) and states:

A. The parties to this dispute are the UCC, which consists of several distressed debt-trading firms who bought RCN’s debt at discount, and APS, an affiliate of AlixPartners, LLC, which provided three interim officers¹ who were key to RCN’s expedited restructuring.

B. APS’ engagement letter with RCN provided for fees computed at APS’ standard hourly rates together with a \$4 million success fee if the Plan was confirmed prior to February 15, 2005. Since the Plan was confirmed in December 2004 and RCN exited bankruptcy after only 28 weeks in Chapter 11, there is no dispute that APS earned the \$4 million success fee in the letter.

C. Payment of the APS \$4 million success fee was baked into the RCN bankruptcy emergence cash flows, which were vetted by all parties in interest in the case, including the advisors to the UCC. Projected cash at emergence was approximately \$140 million, after payment of various expenses, including \$21.794 million in professional fees. That sum included payment of the \$4 million success fee to APS.

¹ (i) John Dubel, President and Chief Operating Officer; (ii) Tony Horvat, Chief Restructuring Officer; and (iii) Gary Schafer, Vice President-Finance. APS also provided other full-time and part-time interim employees to RCN.

D. The UCC contends that, unlike Gaul, bankruptcy professional compensation schemes are divided into two parts: (I) hourly fees for lawyers and accountants, where success fees are only awarded under “extraordinary” circumstances; and (II) flat monthly fees plus more-common success fees for investment bankers and similar financial advisors. Objn. ¶ 6.

E. The UCC attempts to shoe-horn APS into one of these two categories, blithely ignoring the fact that crisis management firms like APS, and competitors such as Alvarez & Marsal, Zolfo Cooper, and Xroads, are different. They base their compensation on standard hourly rates plus success fees. This distinguishing characteristic was noted in the decision of In re Cardinal Industries, Inc., 151 B.R. 843 (Bankr. S. D. Ohio 1993)(Chapter 11 operating trustee awarded a fee of \$2.1 million, plus a success fee of 50,000 shares of stock):

... performance-based or success-factor bonuses are a normal part of compensation arrangements for management restructure consultants and ... such bonuses generally far exceed the time value of the consultant’s services on a lodestar basis. Indeed, the time value component is referred to as the base salary, apparently payable to the consultant even if success is not achieved. [151 B.R. at 847]

F. Mr. Alfred Fasola, the lead independent outside director of RCN’s board of directors during the Chapter 11 case, testified at his deposition (and will similarly testify at the success fee hearing) that, in approving APS’ engagement letter, the board caused the matter to be investigated and determined that APS’ fee structure, including success fee, was “at market.”

G. The UCC argues that the success fee in the APS engagement letter is not relevant, because the Final Order retaining APS (Dkt. No. 131) specifically stated that “all references to ‘Contingent Success Fee’ in the engagement letter and the Application shall be deemed stricken.” (Objn. ¶ 2) However, candor to this Court should have required the UCC to indicate that the sentence in the Final Order does not stop with the word “stricken,” but continues with the immediately following words “without prejudice.” The “without prejudice” wording guts the

entire argument the UCC is making, and that's why the UCC omitted the "without prejudice" wording from its objection.

H. APS submits that, based upon the compensation structure of the crisis management profession, it is not required to prove that its results were extraordinary or unexpected, merely that the specified contingency was triggered (in this case, confirmation prior to February 15, 2005). However, APS submits that its results *were* extraordinary and unexpected. APS personnel led the restructuring process, working closely with the RCN board, and were involved in all negotiations to achieve the following benefits for the estate:

- Chapter 11 case lasted a mere 28 weeks.
- Debtors emerged with a strong balance sheet.
- Amendment to franchise agreements eliminating \$720 million of build-out obligations.
- Successful refinance for in excess of \$400 million of senior secured debt.
- Successful renegotiation of over \$30 million evergreen facility.
- SG&A cost reduction process, wringing out millions of dollars in costs.
- Real estate lease negotiations, providing annualized savings of millions of dollars.
- Employee turnover was limited.
- Got all parties to a consensual term sheet on May 26, 2004 and kept this term sheet on track during the Chapter 11 case.
- Avoided costly filings of non-debtor entities and a time-consuming substantive consolidation fight.

I. The UCC states, incorrectly, that "most of the terms of the Plan had been finalized prior to APS's retention ..." Objn. ¶ 13. The UCC's version of events stands in stark contrast to

the averments of the adversary proceeding complaint in RCN Corporation v. Merrill Lynch Pierce Fenner & Smith Inc., no. 04-04524-rdd: “RCN was forced to start from scratch by hiring new financial advisors to develop realistic business and restructuring plans and to restore creditor confidence. [Compl. ¶ 5] ... On or about February 11, 2004, in recognition of Merrill’s failure to produce any results during its ‘restructuring’ efforts, RCN retained AP Services LLC (‘Alix’), an affiliate of restructuring experts AlixPartners. RCN hired Alix, among other things, to advise RCN management regarding development of a realistic, revised business plan and revised projections. [Compl. ¶ 90] ... [T]he President and Chief Operating Officer of RCN [John Dubel of AP Services] recommended a new restructuring plan that was far more realistic, more likely to secure RCN’s long-term financial health, and therefore more likely to appeal to the Senior Lenders and the Ad Hoc Noteholders Committee as the parties with the economic interests in the restructuring. The new plan proposed (a) to restructure the Senior Credit Facility to include reductions in the timing of principal payments and extended payment terms or replace the facility; and (b) to eliminate Merrill’s proposal to issue to the Noteholders’ unsecured debt of approximately \$200,000,000 to \$300,000,000, as unnecessary to protect the Noteholders against a second restructuring in light of the appropriately restructured the [sic] Senior Credit Facility.” Compl. ¶ 91.

J. Darryl Schall of Tudor Investment Corp., Chair of the UCC, testified at his deposition that a success fee based on the timing of confirmation (such as the APS success fee in this case) was “ridiculous” and that he had never heard of such a structure. However,

Bankruptcy Courts have approved to date, for AlixPartners and affiliates, 13 success fees based on the confirmation of plans, two of them in the Southern District of New York.²

K. The UCC cites as a reason to deny APS its success fee the alleged failure to renegotiate a non-debtor office building lease in New York City costing \$1.6 million a year. Peter Aquino, the present CEO of RCN, testified at his deposition that there were approximately 100 real estate leases of both debtor and non-debtor entities on the renegotiation list at the Chapter 11 filing date. It defies common sense that, in a 28-week bankruptcy case, all non-debtor leases could be renegotiated, and since there were at least 100 leases, APS' batting average is .999. Pretty good!

L. As the Dubel declaration shows, AlixPartners (as well as other crisis management firms) regularly receive success fees both inside and outside of bankruptcy cases. When Congress passed the Bankruptcy Reform Act of 1978, it decided to remove the "spirit of frugality" as a factor in bankruptcy professional fees. The reference is now to the cost of comparable services in a non-bankruptcy setting.

² Acterna (SDNY), AmeriServe (Del), Burlington (Del), Direct TV Latin America (Del), Exide (Del), Fleming (Del), Forstmann (SDNY), Fruit of the Loom (Del), Goss Graphics (Del), Harnischfeger (Del), Hayes Lemmerz (Del), Wheeling Pitt (Ohio), Zenith Elec. (Del).

WHEREFORE, APS respectfully requests that this Court overrule the UCC's objection, approve APS' \$4 million success fee, and grant APS such other relief as is equitable and just.

Respectfully submitted,

SHELDON S. TOLL PLLC

By: /s/ Sheldon S. Toll

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Dated: April 5, 2005

CERTIFICATE OF SERVICE

As counsel for success fee claimant AP Services, LLC, I hereby certify that the annexed pleading was served by me today via email on counsel for the Creditors Committee, the Objecting Party, Susheel Kirpalani, Esq. at skirpalani@milbank.com and Lena Mandel, Esq. at lmandel@milbank.com.

Dated: April 5, 2005

 /s/ Sheldon S. Toll

Sheldon S. Toll