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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

DEBTORS' REPLY IN FURTHER SUPPORT OF MOTION FOR ORDER UNDER 11 U.S.C. §§ 105(a), 363(b), 364(c)(1), 503(b) AND 507 AUTHORIZING, APPROVING AND RATIFYING EXIT FINANCING COMMITMENTS AND PAYMENT OF RELATED FEES AND EXPENSES

RCN Corporation ("RCN") and certain of its direct and indirect subsidiaries, debtors and debtors-in-possession in the above-captioned cases (collectively, the "Debtors"), hereby submit this reply (the "Reply") to the objection (the "Objection") of Wells Fargo & Company ("Wells Fargo") and Vulcan Ventures Inc. ("Vulcan" and, together with Wells Fargo, the "Objectors"), in opposition to the Debtors' Motion for entry of an order under 11 U.S.C. §§ 105(a), 363(b), 364(c)(1), 503(b) and 507 authorizing, approving and ratifying the Commitment

Letter[1] which sets forth the terms of the commitment of Deutsche Bank AG Cayman Islands Branch and Deutsche Bank Securities Inc. (together, "Deutsche Bank") to provide the Exit Financing Commitments. In support of this Reply, the Debtors respectfully represent as follows:

PRELIMINARY STATEMENT

1. For the past several months, the Debtors, with the assistance of their financial advisors, have diligently sought to restructure the Debtors' balance sheet in order to maximize the value and recovery of their estates for all stakeholders. These efforts included pursuing asset sales, cash or equity investments and the refinancing of the Debtors' existing debt. Indeed, the proposed New Senior Exit Financing is the culmination of a long solicitation process where the Debtors' financial advisors approached numerous financial institutions regarding the furnishing of a commitment letter to the RCN Companies to replace the existing Senior Credit Facility as a necessary and vital step in the restructuring; a step necessitated by the Senior Lenders' unwillingness to provide financing on terms acceptable to the Debtors. Those negotiations resulted in the Debtors and Blackstone receiving formal proposals from four financial institutions, which included a proposal from Deutsche Bank and, notably, from Wells Fargo Foothill, Inc., an affiliate of one of the Objectors.

2. As noted in the Motion, after completing an extensive negotiation process in which the Debtors' financial and legal advisors negotiated the legal and economic terms of each of the four formal proposals, and after consulting with certain creditor constituencies, the Debtors determined, in their sound business judgment, that the Deutsche Bank financing would

[1] Unless otherwise defined herein, capitalized terms used herein shall have the meanings ascribed to them in the Motion.

best meet the Debtors' restructuring goals. The decision to enter into the Exit Financing Commitments was not only supported by the Senior Lenders and the Noteholders' Committee, but also was the principal reason why the Debtors were able to achieve a consensual restructuring. Accordingly, the Debtors sought approval of the Exit Financing Commitments in order to (a) lay the groundwork for an expeditious exit from chapter 11, (b) provide the Debtors and other parties in interest with more certainty of the Debtors' ability to complete the restructuring and (c) permit the Debtors to take advantage of positive conditions in the capital markets.

3. Against this backdrop, the Objectors, who have no real economic interest in the outcome of these chapter 11 cases,[2] seek to impede these benefits and the substantial progress the Debtors have made in their reorganization efforts by grossly mischaracterizing the facts and inappropriately using the Motion as a platform to raise confirmation objections. For example, the Objectors argue that the need for the financing is premature and that the equity holders have not had the opportunity to negotiate with the Debtors. This point simply ignores the extensive restructuring efforts the Debtors have undertaken over a period of several months prior to commencing these chapter 11 cases and conveniently omits the fact that one of the Objectors presented its own exit financing proposal and conducted extensive due diligence immediately prior to the commencement of these chapter 11 cases.[3] In addition, the Objectors argue that the

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[2] As noted in the Motion, the Debtors owed approximately $1.1 billion with respect to the Senior Notes as of December 31, 2003, and approximately $460 million under its existing secured credit facilities. Given this level of senior debt, there is simply no prospect for a return to equity under any realistic scenario. As such, the Objectors' statement that entering into the Exit Financing Commitments "provides little or no benefit for the Shareholders" is simply irrelevant. See Objections at ¶ 12. Moreover, Court approval of this Motion will not preclude the equity holders from taking the position at a later date in the appropriate context that they are "in the money" and should receive a distribution under a restructuring plan.

[3] Notably, Wells Fargo first acquired its equity interest in RCN in December 2003 when it purchased 251,332 shares of Series B Preferred Stock from Vulcan. In April 2004, Wells Fargo forwarded to RCN its
(continued...)

fees being charged by Deutsche Bank are excessive, but offer no facts or evidence in support of this position and even misrepresent the potential fees that could be owed under the agreements. While the cost of the New Senior Exit Financing is not insignificant, it is reasonable in the context of these cases, and its incurrence is a prudent exercise of the Debtors' business judgment.

4. Equally without merit is the Objectors' argument that the New Senior Exit Financing effectuates a sub rosa plan. Notwithstanding the fact that equity holders are hopelessly out of the money, the New Senior Exit Financing does not improperly affect the rights of creditors or dictate the terms of any plan of reorganization. Nor would entering into the Exit Financing Commitments prohibit equity holders from arguing at a later date in the appropriate context that they are "in the money" and entitled to a distribution. Rather, 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. Indeed, because the Exit Financing Commitments contain market terms, this defeats the Objectors' final argument that the Exit Financing Commitments are not firm commitments since they contain certain conditions that could excuse Deutsche Bank's performance. All four proposals presented to RCN prior to the commencement of these chapter 11 cases contained a condition based on a material adverse change. It is highly unlikely that any exit financing of

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[3] (...continued)
formal proposal to provide the proposed exit financing. Thus, as one of the unsuccessful lenders who proposed to provide the exit financing, Wells Fargo's opposition to the New Senior Exit Financing is motivated by nothing other than its own parochial agenda and self interests and, for that reason, in addition to those set forth throughout this Reply, should be given little, if any, weight.

distressed companies of this magnitude and complexity would not include such a material adverse change condition to funding.

5. Accordingly, for these reasons and the reasons set forth below, the Debtors respectfully request that this Court overrule the Objections and authorize the approval of the Exit Financing Commitments.[4]

ARGUMENT

A. The Business Judgment Rule

6. The Objections attack the soundness of the Debtors' decision to proceed with the New Senior Exit Financing at this time, or at all, as part of a consensual restructuring of the Debtors' long-term debt obligations. These contentions do not provide a legitimate basis to deny the Motion under the business judgment rule.

7. Section 363(b)(1) of the Bankruptcy Code provides, in pertinent part, that "the trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate." 11 U.S.C. § 363(b)(1). The section does not provide guidance as to when it is appropriate for a court to authorize relief thereunder. However, courts in this Circuit "have required that it be based upon the sound business judgment of the debtor." In re RSL Corn Primecall, Inc., Nos. 01-11457 and 01-11469 (ALG), 2002 Banks. LEXIS 367 at*26-27 (Bankr. S.D.N.Y. Apr. 11, 2002). This Court has recognized the applicability of the business judgment rule in the section 363(b) context on several occasions. See In re Adelphia Communications Corp., No. 02-41729 (REG), 2003 Banks. LEXIS 1281 (Banks. S.D.N.Y. Mar.

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[4] The Objectors also make heavy weather of the notice provided by the Debtors. At the request of the Debtors, however, the Court specifically authorized the Debtors at the "first day" hearing on June 2, 2004 to file the Motion on 18 days notice instead of 20 days.

4, 2003) (the "Adelphia Opinion"); In re Global Crossing Ltd., 295 B.R. 726 (Banks. S.D.N.Y. July 24, 2003).

8. In In re Integrated Resources, Inc., 147 B.R. 650 (S.D.N.Y. 1992), Chief Judge Mukasey observed that "the business judgment rule `is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company.'" In re Integrated Resources, 147 B.R. at 656 (quoting Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985); Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984)) emphasis added). Chief Judge Mukasey went on to note that "[c]ourts are loathe to interfere with corporate decisions absent a showing of bad faith, self-interest, or gross negligence," and for that reason, "[c]ourts will uphold the board's decisions as long as they are attributable to any rational business purpose." Id. (citations omitted) (emphasis added). See also In re Lionel Corp.,722 F.2d 1063, 1071 (2d Cir. 1983) (requiring debtor to demonstrate that "there is a good business reason" to sell its 82% interest in another company's stock).

9. Delaware courts have agreed with such business judgment jurisprudence. Most recently, the bankruptcy court in In re ONCO Investment Company, Case No. 04-10558 (JBR) (Bankr. D. Del. April 30, 2004) ("In re ONCO") approved the debtor's exit financing proposed shortly after commencing the chapter 11 cases and despite similar objections by equity holders. See also Paramount Communications, Inc. v. QVC Network Inc., 637 A.2d 34, 45 n. 17 (Del. 1994) (stating that a court should give "great deference to the substance of the directors' decision and will not invalidate the decision, will not examine its reasonableness, and will not substitute [its] views for those of the board if the latter's decision can be attributed to any rational

business purpose."); Solash v. Telex Corp., 1988 Del. Ch. LEXIS 7, at *21 (Del. Ch. Jan. 19, 1988) (noting that "courts have long been reluctant to second-guess such decisions [by a board of directors] when they appear to have been made in good faith.").

10. Because the informed decisions of a board of directors are presumptively valid, a party seeking to challenge a debtor's exercise of business judgment bears a heavy burden. See In re Integrated Resources, 147 B.R. at 656 ("Parties opposing the proposed exercise of a debtor's business judgment have the burden of rebutting the presumption of validity."). To meet that heavy burden, an objecting party must do more than merely disagree with the debtor's decision, as the Objectors do here. Rather, the objector must adduce competent evidence demonstrating that some or all of the following factors are lacking: "(1) the existence of a business decision, (2) disinterestedness, (3) due care, (4) good faith, and (5) according to some courts and commentators, no abuse of discretion or waste of corporate assets." Integrated Resources, 147 B.R. at 656. The Objectors have failed totally to meet this heavy burden.

B. In Their Reasonable Business Judgment, The Debtors Properly Concluded That Securing The New Senior Exit Financing Is Necessary for a Successful Restructuring.

11. The Objectors contend that the Debtors' pursuit of the New Secured Exit Financing at this time is premature and that other restructuring proposals may provide additional value for the Debtors' constituencies. See Objections at ¶¶ 2, 5. Neither contention has any merit.

12. As noted above, the Debtors' decision to enter into the Exit Financing Commitments was the culmination of several months of extensive review and negotiations of various restructuring alternatives and proposals. Spending several more months conducting the

same review and analysis during the pendency of these chapter 11 cases to reach the same conclusion is neither a reasonable use of the Debtors' resources nor beneficial to the Debtors' estates and creditors. That the Objectors may disagree and would apparently have made a different decision than the Debtors, were the decision up to them, is of no significance. The Objectors' rhetorical denouncement of the Debtors' business judgment amounts to rank speculation, not the evidence necessary to meet their heavy burden to overcome the presumptive validity of the Debtors' business judgment.

13. In addition, the payment of the Commitment Fee at this time is necessary to avoid the termination of the commitment for the Facilities, which would unnecessarily delay, and potentially derail, the Debtors' reorganization efforts. The Objectors' blind speculation that the Debtors could replicate the advantageous terms of the New Senior Exit Financing at a later date is pure speculation. When the Debtors approached the debt markets to explore exit financing proposals prior to commencing their chapter 11 cases, the market conditions were ideal. Were the Debtors to re-approach the lenders after a prolonged restructuring process, they would then have little, if any, leverage since any potential lender would know that the Debtors had few alternatives at that time in order to emerge from bankruptcy. This position, coupled with the possibility of a higher interest rate environment, combine to make it highly unlikely that the Debtors would ever see an exit facility as favorable as the one currently before this Court.

14. The propriety of the Debtors' business judgment is further validated by the affidavit of Mr. Timothy Coleman, who is a financial advisor to the Debtors. In his affidavit, Mr. Coleman stated that many of the features and terms of the New Senior Exit Financing make it a very attractive financing package worth securing at this time. Specifically, he noted that the

New Senior Exit Financing represents the culmination of an exhaustive solicitation process for financing that was conducted by Blackstone prior to the Petition Date and that the pricing of the financing was comparable to the pricing of similar exit financing transactions in the current market. Coleman Affidavit ¶¶ 10-11.

15. Accordingly, the Debtors respectfully submit that they have amply demonstrated the soundness of their business judgment in concluding that it is prudent to obtain the commitment for the New Senior Exit Financing at this time. The Objectors offer nothing more than speculative and conclusory second-guessing of the Debtors' business strategies. Such hollow speculation does not rise to the level necessary to satisfy the Objectors' heavy burden in rebutting the presumptive validity of the Debtors' business judgment. For the foregoing reasons, the Objectors have failed to offer any legally sufficient basis to override the presumption accorded under the business judgment rule with regard to the Debtors' business decision to proceed with the Motion at this time.

C. The Debtors, In Their Reasonable Business Judgment, Have Concluded That The Fees Associated With The Exit Financing Commitments Are Reasonable And Justifiable.

16. The Objectors' next attack on the Debtors' business judgment argues that the fees associated with the New Senior Exit Financing are unreasonable and unnecessary. See, Objections ¶ 6. That the fees associated with the New Senior Exit Financing are both reasonable and fair is also supported by the affidavit of Timothy Coleman, an investment banking expert who has substantial experience with financing transactions in the bankruptcy context. Mr. Coleman's opinion is that the fees associated with the proposed New Senior Exit Financing are the types of fees that one would expect to be incurred.

17. Nor are the Objectors justified in attacking the break-up fee proposed in the Exit Financing Commitments. As noted in one of the leading authorities in this District with regard to break-up fees, "[b]y design, a break-up fee is an incentive payment to an unsuccessful bidder who placed the estate property in a sales configuration made . . . to attract other bidders to the auction." In re Integrated Resources, Inc., 147 B.R. at 659 (internal quotations omitted). In addition, break-up fees may also be approved where necessary to "ensure that a bidder does not retract its bid." Id. at 661. In upholding the bankruptcy court's approval of the approximately 1.6% breakup fee at issue in In re Integrated Resources, Chief Judge Mukasy stated that "the bankruptcy courts generally presume that the board's decision to agree to a break-up fee was a valid exercise of its business judgment" and cautioned that "it is not the function of judges to determine the break-up fee." Id. at 660.

18. Courts both within, and without, this District regularly approve break-up fees ranging as high as 4% of the total transaction amount. See, e.g., In re Petrie Retail, Inc., et al., Case No. 95-44528 (AJG) (Bankr. S.D.N.Y. April 23, 1997) (fee of 2% upheld for sale of G&G Shops); In re Integrated Resources, Inc., 147 B.R. 650, 662 (S.D.N.Y. 1992) (upholding bankruptcy court approval of break-up fee of approximately 1.6%; expert testified that outside of bankruptcy break-up fees average 3.3%); In re Crowthers McCall Pattern, Inc., 114 B.R. 877 (Bankr. S.D.N.Y. 1990) (approving 1.1% break-up fee); In re Hechinger Investment Company Inc., Case No. 99-2261 (PJW) (Bankr. D. Del. October 1, 1999) (fee of 3% upheld); In re Montgomery Ward Holding Corp., Case No. 97-1409 (PJW), (Bankr. D. Del. February 17, 1998)(fee of 4% upheld). In contrast, the fees payable to Deutsche Bank in the event the Debtors do not proceed with the New Senior Exit Financing are one percent, and one and half percent if

the Debtors pursue a competing transaction. Although not insignificant, the Objectors offer no cases, evidence or support for their baseless claim that such fees are unreasonable.

19. In summary, notwithstanding the Objectors' hollow protestations to the contrary, the fees associated with the New Senior Exit Financing are reasonable and justified. They serve the valuable function of locking in a commitment from Deutsche Bank for up to $460 million of exit financing at market rates. Rational business justifications informed the Debtors' exercise of their business judgment in concluding that the fees are reasonable and justified, and because the Objectors have failed to offer any credible basis to rebut the presumptive validity of the Debtors' business judgment, this Court should grant the Motion.

D. The Exit Financing Commitments Allow The Debtors To Negotiate The Terms Of A Consensual Plan, and do Not Constitute a *Sub Rosa* Plan.

20. The Objectors argue that approval of the Exit Financing Commitments would facilitate a sub rosa plan of reorganization, resulting in prejudice to parties that may object to what the Objectors characterize as the "Outline Plan" and chilling consideration of alternate plans. As discussed below, this argument lacks merit. The Court's approval of the Motion will not, in fact, predetermine the terms of a plan of reorganization. While the Exit Financing Commitments require that the Debtors propose, and this Court confirm, a plan reasonably acceptable to Deutsche Bank, the Exit Financing Commitments provide the Debtors with the necessary flexibility to address the myriad issues and complexities that still exist at this stage of these chapter 11 proceedings. The Exit Financing Commitments do not lock the Debtors into any particular plan, and the Debtors maintain flexibility with respect to their plan.

21. Deutsche Bank is incentivized to agree to work with the Debtors to accommodate a plan on the terms desired by the Debtors and their various creditor constituencies because, unless and until Deutsche Bank provides the funding under the Exit Financing Commitments, they will not be entitled to the majority of their fees. This sets up a powerful economic incentive for Deutsche Bank to work with the Debtors in formulating a plan, and to not unreasonably withhold their consent to a plan of reorganization upon which the Debtors and their creditors may ultimately agree. Deutsche Bank can be expected to be highly motivated to pursue and close the New Senior Exit Financing.

22. The Objectors ignore these incentives and the protective provisions of the Commitment Letter in an obvious attempt to raise plan and confirmation related issues at this juncture simply to gain perceived leverage over the Debtors. These issues are premature and should not be aired now. See, e.g., The Bank of New York, et al. v. Adelphia Communications Corporation, et al., (In re Adelphia Communications Corporation, et al.), Adv. Pro. 03-93825 (REG) (Bankr. S.D.N.Y. 2004) ("consideration of confirmation comes at a markedly later time in the process").

23. Contrary to the assertions of the Objectors, the Debtors are not seeking approval of any particular plan at this time. The overall plan process - the disclosure statement, voting and confirmation hearings - will provide the appropriate environment to decide the confirmation issues and concerns the Objectors purport to raise.

24. Moreover, the Objectors cite no authority to support their assertion that approval of a commitment for exit financing would constitute approval of a sub rosa plan of reorganization. On the contrary, in a recent case, based on almost identical facts, the bankruptcy

court for the District of Delaware approved the debtors' request to approve an exit facility shortly after the debtors filed their cases. See In re ONCO. In In re ONCO, the debtors also faced objections by equity holders who opposed the exit financing on the same arguments, including that the debtors were seeking to effectuate a sub rosa plan. However, in an order dated April 30, 2004, the In re ONCO court rejected the equity holders objections and authorized the debtors entry into the new exit financing.

25. In general, a transaction is not a sub rosa plan of reorganization where the transaction does not (a) impermissibly restructure the rights of creditors; (b) dictate the terms of a chapter 11 plan; or (c) dispose of all the claims against the debtor. See Official Comm. of Unsecured Creditors v. Cajun Elec. Power Cooperative, Inc. (In re Cajun Elec. Power Cooperative, Inc.), 119 F.3d 349 (5th Cir. 1997) (holding that a proposed settlement was not a *sub rosa* plan because it only disposed of one of the debtor's assets, did not restrict the creditors' ability to vote on a future plan and did not dispose of all the claims against the debtor); In re Trans World Airlines, Inc., 2001 WL 1820326 (Bankr. D. Del. Apr. 2, 2001) (holding that a sale of substantially all of a debtor's assets was not a *sub rosa* plan of reorganization); In re Braniff Airways, Inc., 700 F.2d 935 (5th Cir. 1983) (same).

26. Unlike In re Cajun Electric Power and In re Trans World Airlines, the Exit Financing Commitments do not dictate the terms of a restructuring, dispose of all claims against the Debtors, or restrict creditors' rights to vote as they deem fit. See In re Flight Transportation Corporation Securities Litigation, 730 F.2d 1128 (8th Cir. 1984) (holding that a sharing agreement pursuant to which certain creditors and shareholders settled claims to an escrow fund that was the subject of litigation, is not a sub rosa plan under Braniff because the agreement (i)

does not dictate terms of future plan since assets will be distributed in normal course, and (ii) claimants are not required to vote in favor of any future plan); In re Trans World Airline, Inc., et al., 2001 Bankr. LEXIS 980 (Bankr. D. Del. 2001) (holding that sale agreement and order did not constitute an impermissible sub rosa plan under Braniff because they did not dictate the terms of debtor's future plan, dictate creditor voting rights, or contain a release provision); In re Babcock and Wilcox Company, 250 F.3d 955, 960 (5th Cir. 2001) ("Braniff stands merely for the proposition that the provisions of section 363 permitting a trustee to use, sell, or lease the assets do not allow a debtor to gut the bankruptcy estate before reorganization or to change the fundamental nature of the estate's assets in such a way that limits a future reorganization plan").

27. A more germane case is In re Allegheny International, Inc., 117 B.R. 171 (W.D. Pa. 1990) in which the court overruled the equity committee's objection that a commitment letter circumvented confirmation requirements because it impermissibly dictated the terms of a then-unified plan of reorganization. The court stated that "the commitment letter contains certain terms which might dictate the terms of a future plan of reorganization, but does not dictate the terms of any plan of reorganization." Id. at 176. Further, the Court noted that if creditors did not find the plan to be acceptable, the creditors could reject it. Id. Because creditors were still afforded rights under the Bankruptcy Code regarding the issues of disclosure, voting, and priority, the Court held that Braniff was not applicable.

E. The Exit Financing Commitments Represent a Firm Commitment by Deutsche Bank, Subject Only To Narrow And Limited Exceptions.

28. The Objectors argue that Deutsche Bank's commitment to provide funds under the Exit Financing Commitments is insufficient because it is subject to conditions

precedent and gives Deutsche Bank unlimited discretion to opt out of its commitment. As discussed below, this argument is without merit. Contrary to the Objectors' assertions, Deutsche Bank cannot simply "opt out of funding due to various circumstances." The conditions precedent to funding set forth in the Deutsche Bank Exit Financing Commitments are limited in scope and reflect standard market terms under the circumstances.

29. The Objectors characterize the material adverse effect provision in the Commitment Letter (the "MAE") as "the antithesis of a funding commitment." The Objectors further assert that the "market out" provision the Commitment Letter gives Deutsche Bank "unfettered flexibility to dodge their commitments." Both of these assertions are erroneous. The Objectors ignore that, to the extent a dispute ever arises as to whether Deutsche Bank can escape its commitments, such a dispute will be determined by this Court. For example, to meet the exceptional standard of the market out clause, Deutsche Bank would have to demonstrate, to the satisfaction of this Court, that an MAE in the financial markets has occurred and such an MAE could be expected to materially adversely affect the syndication. Rather than permitting Deutsche Bank to opt out of their commitments whimsically, the Commitment Letter provides only a limited right not to fund in the event of the occurrence of an MAE measured on an objective basis.

CONCLUSION

WHEREFORE, the Debtors respectfully request entry of an order, substantially in the form annexed to the Motion, granting the relief requested in the Motion and such other and further relief as this Court may deem just or proper.

Dated: New York, New York
June 21, 2004

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