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Hearing Date: July 1, 2004

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

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

OBJECTION OF PREFERRED SHAREHOLDERS WELLS FARGO & COMPANY AND VULCAN VENTURES INC. TO DEBTORS' MOTION FOR ORDER UNDER 11 U.S.C. §§ 105(a) and 363(b)(1) AUTHORIZING THE CONTINUATION OF AN EXISTING EMPLOYEE RETENTION AND SEVERANCE BENEFIT PLAN

Wells Fargo & Company and Vulcan Ventures Inc. (together, the "Shareholders"), holders of RCN Corporation ("RCN") preferred stock, by and through its undersigned counsel, Andrews Kurth LLP, hereby make the following Objection to Debtors' Motion (the "Motion") For Order Under 11 U.S.C. §§ 105(a) and 363(b)(1) Authorizing the Continuation of an Existing Employee Retention and Severance Benefit Plan (the "Bonus Plan").

INTRODUCTION

1. The Debtors fail to make the showing required under the business judgment rule to merit the application of the rule and approval of the Motion. The Motion contains nothing but blanket assertions that the Bonus Plan is in the best interests of the Debtors. The Debtors fail to establish that in approving the Bonus Plan, the Board of Directors acted on an informed basis; nor is there any showing that the Bonus Plan serves a "good business reason," as is required under the business judgment rule. Therefore, the Motion should be denied.

ARGUMENT

2. It is well settled that the employment agreements submitted for approval must be carefully examined by this Court. Bankruptcy courts have the responsibility to scrutinize the economic and factual substance of debtors' employment proposals for senior managers. *See In re Zerodec Mega Corp.*, 39 B.R. 932, 933 (Bankr. E.D. Pa. 1984) ("cases under the Code . . . are in agreement that the bankruptcy court has ample authority to rule on the employment of the debtor's officers and fix their compensation."); *In re Lyon & Reboli, Inc.*, 24 B.R. 152, 153 (Bankr. E.D.N.Y. 1982) ("court has inherent power to reduce [officers'] salaries under § 105(a) of the Bankruptcy Code."); *In re Hooper, Goode Realty*, 60 B.R. 328, 332 (Bankr. S.D. Cal. 1986) ("the employment of the debtor's officers is subject to court scrutiny . . .").

3. Utilizing their equitable powers, bankruptcy courts may deny a debtor's motion to enter into an employment contract or approve a contract subject to modifications that the court itself imposes based on its findings of fact. *See, e.g., In re Gibson & Cushman Dredging Corp.*, 103 B.R. 399, 403 (Bankr. E.D.N.Y. 1989) (approved contract to employ CEO but struck "the cash payments called for on its signing," where the lump-sum payment was large relative to the debtor's available capital and the filing of a plan was imminent).

4. Courts have imposed two prerequisites for the application of the business judgment rule.[1] First, the "business judgment 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 Adelphia Communications Corp.*, 2003 WL 22316543, *30 (Bankr. S.D.N.Y. 2003) (citing *Smith v. Van Gorkom,* 488 A.2d 858, 872 (Del. 1985). Second, the Debtors bear the burden of producing evidence to establish a "good business reason" for a proposed transaction outside of the ordinary course of business. *Committee of Equity Security Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1071 (2d Cir. 1983) (sustained objection to debtor's motion to sell an asset outside of the ordinary course of business and outside of a plan of reorganization and remanded for further proceedings).

A. THERE IS NO EVIDENCE THAT THE BOARD ACTED ON AN INFORMED BASIS OR THAT THE BONUS PLAN IS IN THE BEST INTERESTS OF THE DEBTORS

5. The Motion lacks any showing that the Debtors' Board of Directors complied with its obligations under the business judgment rule by acting on an informed basis or that the Board's approval of the Bonus Plan is in the Debtors' best interests. The Motion merely mentions that the Board met twice pre-petition: once to approve the Bonus Plan and once (the day before filing) to modify it. However, the Motion omits mention of the substance of any discussions the Board conducted in considering the Bonus Plan or structuring its terms.[2] The

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[1] While seeking this Court's approval of the Motion, the Debtors also appear to argue that such approval is not required since their implementation of the Bonus Plan is a transaction in the ordinary course of business. Motion, ¶ 43. However, only a few paragraphs later, the Debtors contradict themselves by citing five decisions in the Southern District of New York that involved applications for approval of similar plans under § 363(b).

[2] As it now stands, the Bonus Plan divides participants into four tiers: the Chief Executive Officer, Tier 1 (seven senior executives), Tier 2 (eight vice-president level employees), and Tier 3 (60 employees at the management level or above). The Bonus Plan provides for payment of 75% of the retention bonus to the CEO, which equals 120% of his base salary, upon the earlier of completion financial restructuring of the Debtors or approval of their plan of reorganization (the "Second Payment Date"). In addition to receiving 25% of their Retention Bonuses pre-petition, Tier 1, 2, and 3 Participants would receive another 50% of their Retention Bonuses

Debtors likewise fail to set forth whether the Board evaluated the necessity of the Bonus Plan to the company's restructuring effort. The Debtors' failure to present this Court with a complete record describing the Board's process in approving the Bonus Plan does not enable this Court to establish that the Board acted on an informed basis and therefore does not provide this Court with a sufficient factual record to grant this Motion.

6. Even more glaring is the Debtors' omission of any showing justifying the payment of the severance benefits to the CEO equal to his base salary if his employment with the Debtors terminates for virtually any reason between May 10, 2004 and six months following the Second Payment Date. The Motion is wholly devoid of explanation as to why such benefits are reasonable or what information the Board considered in evaluating the propriety of offering such severance benefits to the CEO.

B. THE DEBTORS FAIL TO SET FORTH A GOOD BUSINESS REASON FOR IMPLEMENTING THE BONUS PLAN

7. The Motion fails to set forth a good business reason for approval of the Bonus Plan, as required by *Lionel*. Rather, the Bonus Plan appears to induce senior management to merely remain employed rather than motivate such executives to maximize the value of the Debtors' estates for the benefit of all Shareholders. A total of 75% of the CEO's and Tier 1 and 2 participants' Retention Bonuses will be received simply so long as such employees remain with the company on the Second Payment Plan.[3] By motivating survival instead of job performance, the Bonus Plan runs counter to the goals of this reorganization, which is to provide maximum value to all constituencies. Furthermore, the Debtors do not establish that absent the Bonus Plan, the Debtors' senior employees would immediately leave.

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on the Second Payment Date. Such Retention Bonuses would equal to 80% of base salary for Tier 1 employees, 50% of base salary for Tier 2 employees, and 10-20% of base salary for Tier 3 employees. Most senior employees are also likely to receive substantial stock option packages as part of a plan of reorganization.

[3] The remaining portion of the Retention Bonus is tied to performance targets, but there is no showing anywhere in Debtors' papers what such performance targets are.

8. While approving an executive's contract in *Adelphia*, Judge Gerber expressed concern that severance payments triggered by a "Good Reason" termination (in that case, decoupling of the executive's roles as Chairman and CEO) have the effect of a "poison pill" by discouraging a later action by the Board that may be required in a restructuring. 2003 WL 22316543, *34-35. Judge Gerber expressed such concern because a restructuring may involve reshuffling of executives duties and responsibilities that would trigger a "Good Reason" clause. *Id.* Similar "Good Reason" clauses applicable to severance bonuses for Tier 1 and 2 employees might serve to entrench current management and impede a successful reorganization. This provision discourages a successful reorganization of the Debtors and appears unjustified and unwise.

WHEREFORE, for the reasons stated herein, the Shareholders respectfully request that the Court enter an order: (a) denying the Debtors' Motion, and (b) granting Shareholders such further relief as is just and proper.

Dated: New York, New York
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Respectfully submitted,

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