

Hearing Date: July 1, 2004 at 10:00 a.m.

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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)
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Debtors. : (Jointly Administered)
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**DEBTORS' REPLY TO 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 BENEFITS PLAN**

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 in response to the Objection of Preferred Shareholders Wells Fargo & Company and Vulcan Ventures Inc. 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 Benefits Plan (the "Objection"). In response to the Objection, the Debtors respectfully represent as follows:

PRELIMINARY STATEMENT

1. By the Motion,¹ the Debtors have proposed to continue a modest employee retention and severance program (the "KERP") for certain of their highly qualified employees in a financially troubled business operating in a specialized and complex industry. The KERP will cost the Debtors approximately \$3.45 million for retention payments and, at most, \$6.1 million for severance payments in the unlikely event that all participants are terminated. Wells Fargo & Company ("Wells Fargo") and Vulcan Ventures Inc. ("Vulcan", and, together with Wells Fargo, the "Objectors"), two out of the money shareholders, now seek to derail the RCN Companies' hard fought efforts to establish a fair and competitive employee retention program which is important to the RCN Companies' ability to reorganize.

2. The Objectors do not offer any evidence, or even allege, that the KERP is unreasonable or excessive. Rather, the Objectors simply query whether the Debtors have presented a sufficient record to enable the Debtors to take advan-

¹ Capitalized terms not otherwise defined shall have the meanings ascribed to them in the Motion.

tage of the business judgment presumption.² As set forth herein, and as the Debtors will demonstrate at the hearing on the Motion, the KERP was (i) approved by an informed board of directors, acting in good faith, (ii) negotiated at arms' length with the Noteholders' Committee and the Senior Lenders and (iii) supported by a sound business justification. Significantly, nothing in the Objection alleges anything to the contrary. Accordingly, the KERP should be approved as a reasonable exercise of the Debtors' business judgment.

THE KERP APPROVAL PROCESS

3. In October 2003, the RCN Companies began preliminary discussions with the Noteholders' Committee and the Senior Lenders concerning a possible restructuring. In light of these discussions, and shortly thereafter, the RCN Companies determined that an employee retention program would be essential to their restructuring efforts, as the ability to consummate any restructuring would be

² It should be remembered that Vulcan had the opportunity to participate in the formulation of the KERP if it so desired. Vulcan had representatives on the Board of Directors in the fall of 2003 when the restructuring negotiations were beginning. For its own personal reasons, Vulcan chose to have its representatives resign from the Board at that time so that Vulcan could be free to sell its equity. Vulcan should not now be permitted to second guess the informed business judgement of the Board of Directors, when Vulcan chose not to participate. Wells Fargo was the purchaser of certain of Vulcan's equity interest in December, 2003, for a relatively nominal amount. Wells Fargo similarly should not be permitted to knowingly step into an out of the money equity position for a nominal sum, as a favor to Vulcan, and then use that position to try to blow up this prearranged successful restructuring.

predicated upon retaining key personnel at least through consummation. The RCN Companies feared that, in the absence of a customary retention program, key employees would spend a considerable amount of their time and energies seeking alternate employment, rather than focusing on the immediate task at hand, the RCN Companies' restructuring efforts.

4. In December 2003, the Chief Executive Officer, the General Counsel and the Vice President of Employee Services presented a proposed employee retention program (the "Initial KERP") to the compensation committee (the "Compensation Committee") of RCN's board of directors (the "Board"), which committee consisted entirely of outside directors. The Initial KERP was approved by the Compensation Committee on December 15, 2003, subject to Board approval and discussions with the Senior Lenders and the Noteholders' Committee.

5. The Initial KERP was ratified in concept by the Board on January 12, 2004, with the understanding that further negotiations would take place with the Senior Lenders and the Noteholders' Committee. The Board had been informed by the Vice President of Employee Services and the General Counsel that retention programs for other similar companies had been considered in formulating the terms of the KERP.

6. Over the next several weeks, the RCN Companies conducted negotiations at arms' length and in good faith with the Senior Lenders and the

Noteholders' Committee regarding the terms of the Initial KERP to arrive at an economical yet effective retention plan that would ensure the continued participation and motivation of key personnel in connection with the RCN Companies' restructuring efforts. The Senior Lenders and Noteholders' Committee suggested modifications (the "Modifications") to the Initial KERP, including (i) extending the date of the first retention payment, (ii) shifting a larger percentage of the payments to coincide with confirmation of a reorganization plan, (iii) reducing the total number of participants, and (iv) reducing the overall cost of the program.

7. On February 10, 2004, the Board met again to consider the KERP and the Modifications. At that meeting, the Board, after a detailed presentation of the relevant facts, unanimously approved a modified KERP reflecting certain of the Modifications. Subsequently, however, as part of the overall restructuring negotiations, the RCN Companies and the Noteholders' Committee engaged in further discussions regarding the KERP, during which additional modifications were negotiated, resulting in the following additional agreed-upon modifications: (i) certain portions of the severance payments became subject to mitigation; (ii) the severance tail period was significantly reduced; (iii) KERP participants were required to waive any claims under the then-existing Chairman's Plan; and (iv) the amount of severance benefits for the Chief Executive Officer were significantly reduced. It is noteworthy that the RCN Companies were represented in these final KERP negotia-

tions by Mr. John Dubel, the RCN Companies' new President, who is not a participant in the KERP but who has over 20 years of experience in restructuring work, including KERP negotiations. The Board met again on May 26, 2004 and approved a further modified KERP program reflecting these additional modifications.

ARGUMENT

8. This Court should approve the KERP if the Debtors demonstrate a sound business justification for implementing it. See In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983); In re Delaware Hudson Ry. Co., 124 B.R. 169, 179 (Bankr. D. Del. 1991). Once the Debtors articulate a sound business justification, "[t]he 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, Inc., 147 B.R. 650, 656 (S.D.N.Y. 1992) (quoting Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985)) (emphasis added). The sound business justification for the Debtors' KERP is the retention of certain key employees whose continued services are vital to the Debtors' efforts to consummate a restructuring.

9. "[P]arties opposing the proposed exercise of a debtor's business judgment have the burden of rebutting the presumption of validity." In re Adelphia Communications Corp., 2003 WL 22316543, at *31 n.148 (Bankr. S.D.N.Y. March 4, 2003). The Objectors have offered no evidence whatsoever to

rebut the presumption that the Board 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." Instead, they simply state that the Debtors have failed to meet their burden. Additionally, in their Objection, the Objectors stand the business judgment rule presumption on its head. They allege that the Debtors failed to demonstrate that the Board acted on an informed basis, and paradoxically, are therefore not entitled to the benefit of the presumption that the Board acted on an informed basis.

10. Although it is not the Debtors' burden to demonstrate in the first instance the factors that are the subject of the presumption, the business judgment standard has been satisfied because:

- a. The Compensation Committee that evaluated the KERP was comprised entirely of outside directors;
- b. Between the Board and the Compensation Committee, there were at least four meetings to discuss and approve various iterations of the KERP, culminating with the approval of the KERP on May 26, 2004;
- c. The Board was provided detailed information on the terms of the KERP, the costs of the retention and severance components of the program, and the reasons for instituting such a program;
- d. The KERP was negotiated over several months at arms' length with the Senior Lenders and the Noteholders' Committee, with the final negotiations being led by Mr. John Dubel who does not participate in the KERP but has over 20 years experience in negotiating KERPs and other restructuring matters; and
- e. Based upon all of the foregoing, it was the Board's reasonable judgment that the KERP is necessary to the RCN Companies' restructuring efforts.

11. The Objectors complain about an alleged insufficient explanation justifying severance benefits to the Chief Executive Officer. It was the Debtors' reasonable business judgment that such benefits were necessary to retain the services of the Chief Executive Officer through the difficult restructuring period. Notably, in exchange for participation in the KERP, the Chief Executive Officer agreed to (i) reduce his severance from the 2-year salary obligation currently in place to the proposed 1-year obligation under the KERP, and (ii) waive his claims under the Chairman's Plan, which claims arguably could equal \$2.5 million.

12. The Objectors additionally allege that the Debtors have not set forth a "good business reason" for seeking approval of a retention plan that induces participants to "merely remain employed." Although the Objection implies that retention plans not heavily weighted to, and conditioned up, performance criteria, do not serve a sound business purpose, there is no such requirement, and not surprisingly, the Objectors do not cite any support for the extraordinary proposition. Furthermore, the KERP does contain a performance component. In fact, 25% of the retention bonus payment for the key senior leadership employees is predicated upon performance and, thus, there is also no substance to this objection.

13. For the foregoing reasons, and as will be demonstrated at the hearing on the Motion, the Debtors have established a sound business purpose for the KERP, and accordingly, the KERP should be approved.

WHEREFORE, the Debtors respectfully request that the Court
(i) overrule the Objection (ii) enter an order authorizing the Debtors to continue the
Key Employee Retention and Severance Plan and (iii) grant such other and further
relief as is just and proper.

Dated: New York, New York
June 30, 2004

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/s/ Jay M. Goffman

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