MEMORANDUM

TO: Bankruptcy Rules Advisory Committee

FROM: Bankruptcy Judges Advisory Group

RE: Rule 6003

DATE: April 24, 2008

The Bankruptcy Judges Advisory Group (BJAG) respectfully offers the following comments and proposals to the Bankruptcy Rules Advisory Committee regarding the need for further clarification of Rule 6003 as it pertains particularly to the employment of professionals during the 20-day period before the entry of a retention order. The majority of members believe that clarification would be helpful, but there is a minority view that no clarification is needed.

Majority View

Rule 6003 was apparently promulgated for two purposes: (a) to reduce the likelihood of forum or venue shopping by promulgating national rules which would establish uniformity of procedures for first day orders, and (b) to provide the court and the parties with an opportunity to consider retention of professionals at a time beyond the first few days of the case.[1] Most of the BJAG members have concerns about whether the rule will accomplish either goal.

As to the goal of achieving uniformity of procedures, the range of opinions among BJAG members, as well as Judge Massey's decision in In re Russell Smith, Case No. 08-63990, Bankr. N.D. Ga (Order of March 17, 2008), demonstrate that local rules, practices and customs will continue to influence the actual results reached under the new rule among the districts and even among judges within the same district. Some judges view the retention of counsel of sufficient importance that the absence of counsel would constitute "immediate and irreparable harm" to the estate in virtually all cases. The quantity of work necessary during the first 20 days of most Chapter 11 cases (i.e. preparation of schedules, cash collateral, DIP loans, 365(d)(4) issues, etc.)

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[1] Memorandum to Advisory Committee on Bankruptcy Rules Re: Rule 6003 by Jeff Morris, Reporter, 3/20/08.

would support such a conclusion. Some judges are likely to view the "shall not" language in the rule under a plain meaning analysis and enter no order whatsoever for at least 20 days. In those districts, counsel may believe that it is acting at its peril pending the entry of an order. This may result in a reluctance to take small or non-public company Chapter 11 cases, demands for greater retainers, or minimal work being accomplished during the first few weeks of the case. The risk to counsel may be substantial. The UST's action in Judge Massey's case demonstrates this point. A contentious major creditor or the UST may intimidate counsel from acting during the early days of the case.

The goal of uniformity in procedures for first day orders may also be frustrated by the "immediate and irreparable harm" loop hole in the rule itself. If the court finds that the lack of counsel would cause "immediate and irreparable harm," it can approve retention "to the extent necessary" to avoid such harm. Subject to the likely variance in the standards for determining immediate and irreparable harm, the spirit of the rule could be effectively negated by local practices.

The second goal of the amendment, i.e., providing the court and the parties with an opportunity to consider retention at a time beyond the first few days of a case, is furthered by the new rule. We understand that the general consensus of the Committee is that Rule 6003 allows for the employment of counsel for the debtor-in-possession from the inception of the Chapter 11 filing, that the rule only limits the timing for the entry of the order approving retention and not the timing of the commencement of the actual retention, and that there is provision for immediate entry of a retention order where immediate and irreparable harm is shown. Nevertheless, the majority of BJAG members believe that the rule as it has been enacted creates uncertainty about whether DIP counsel may serve and be paid from the date of filing, assuming that they file their application timely and are otherwise qualified to serve. The level of uncertainty is evidenced in Judge Massey's opinion in Smith, in which he resolves the matter in accordance with the Committee's understandings. To reach that outcome, however, required the expenditure of time and legal resources by the court, the U.S. Trustee and counsel for the DIP. Counsel no doubt also charged the estate for his time. As well, uncertainty is created for corporation and partnerships, who may not appear in federal court without counsel. See 28 U.S.C. § 1654.

BJAG members have outlined other concerns about the impact of the rule. While a more deliberative process for Chapter 11 retentions appears to have been the focus of the rule, the impact on Chapter 7 trustees should also

be considered. Chapter 7 trustees may need to move expeditiously to protect assets of the estate or to take other actions within 20 days of the filing of a petition. Having orders appointing counsel placed in doubt may impede trustees in the performance of their statutory duties and impose additional delay and expense on a system that is already under stress.

Another concern is the line of cases that limit the entry of a retention order nunc pro tunc absent a showing of extraordinary circumstances. See, e.g., In re Milwaukee Engraving Co., 219 F.3d 635 (7th Cir. 2000), cert. denied, 531 U.S. 1112, 121 S.Ct. 856, 148 L.Ed. 2d 770 (2001), In re Jarvis, 53 F.3d 416, 420 (1st Cir. 1995) (extraordinary circumstances needed to justify nunc pro tunc appointment); In re El Paso Refinery, LP, 37 F.3d 230 (5th Cir. 1994); In re Triangle Chemicals, Inc., 697 F.2d 1280 (5th Cir. 1983).

Also cited as problematic is the impact of the rule on the entry of such orders as those used to establish bidding procedures. Read literally, the rule bars "grant[ing] relief" even for setting up bidding procedures for a sale during the first 20 days of the case.

The discussion among BJAG members has produced several alternative proposals, as follows:

1. A recommendation to amend Rule 6003 follows:

> Except to the extent that relief is necessary to avoid immediate and irreparable harm, the court shall not, within 20 days after the filing of the petition, ~~grant relief~~ issue an order granting ~~regarding~~ the following:
> (a) an application under Rule 2014. . .

The Advisory Committee Note might read as follows:

> Rule 6003 is amended to clarify that it is only the issuance of an order granting the application or motion that must be delayed until more than 20 days after the filing of the petition, and that Rule 6003 does not preclude a provision in the order making the relief effective as of a date earlier than the issuance of the order. In particular, the rule is amended to clarify that in the case of an application under Rule 2014, the Rule does not bar the professional from representing the trustee or the debtor in possession during the period prior to the issuance of the order, or bar a provision in the retention order that the authorization of

employment is effective as to representation during that period. Nor does the Rule bar the granting of relief on preliminary matters such as establishing bidding procedures in connection with the proposed sale of estate property.

2. A recommendation to follow the procedural model for cash collateral and DIP loans under Rules 4001(b) and (c) by amending the rule to provide that final orders on retention applications shall be entered after no less than 20 days notice, but that interim orders may be entered on an ex parte basis if the court determines that the applicant satisfies the requirements of section 327. No immediate and irreparable harm standard for interim authorization is necessary because legal representation will be necessary in every case.

3. A recommendation that the time bar should not be from the petition date, but from the date the application is filed. This will prevent applicants from evading the rule by filing their application 10 or 15 days after the petition date and seeking approval on day 21. It is the time between notice of the application and final approval that is important, not the time between the petition date and final approval of the retention.

4. A grammatical fix to change the "and" at the end of subsection (b) to "or", to recognize that one order will not provide for the three alternatives listed. All BJAG members agree with this proposed change.

Minority View

Several BJAG members disagree that changes to Rule 6003 are needed (1) to clarify Rule 6003 as not barring compensation to professionals for the period after filing of the application and before granting of the application, (2) to provide for interim orders approving employment pending a final order, or (3) to prevent "gaming" of Rule 6003 that can arise from the filing of the application only a few days before day 21 of the case.

I

These members believe that Judge Massey's interpretation of Rule 6003 as not barring representation until the application is granted is correct. The common practice in many places is to hold retention applications for a period

of time, usually 10 or 15 days, before a retention order is entered. During this time, necessary legal work is routinely performed which is later compensated. We have not heard of a challenge to the compensation of professionals for work performed after an application is filed but before the order is entered. See In re Smith, supra, at 4 ("This Court has not been able to find a single case that states that even though the trustee filed a timely application to employ, such work undertaken prior to the entry of the order granting the application is without legal effect or otherwise improper or may not be compensated.").

Rule 6003 works appropriately whether it is a debtor in possession or a trustee who files an application to employ a professional in the first 20 days of a case. In both instances, the authorization of employment will relate back to the date of the application (if not earlier).

The judges who hold the view that the rule need not be changed are not persuaded by the cases cited above that there is any problem with Rule 6003. In re Jarvis, 53 F.3d 416 (1st Cir. 1995) addressed an application for employment filed after the professional had performed the work at issue, and held that:

> [A] bankruptcy court may grant such a *post facto* application, but only if it can be demonstrated (1) that the employment satisfies the statutory requirements, and (2) that the delay in seeking court approval resulted from extraordinary circumstances.

In re Jarvis, 53 F.3d at 418. When (1) a professional meets the statutory requirements (of disinterestedness, etc.) and (2) the application for employment is filed *before* the services are performed, it follows from Jarvis that the application can later be approved effective as of the date of its filing.[2]

In contrast, In re Milwaukee Engraving Co., 219 F.3d 635 (7th Cir. 2000), addressed a professional who, as of the filing of the application and commencement of representation of the debtor in possession, did *not* meet the statutory requirements to be employed, leading to denial of the application to

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[2] In re Triangle Chemicals, Inc., 697 F.2d 1280 (5th Cir. 1983) also addressed the same issue as In re Jarvis. In re El Paso Refinery, LP, 37 F.3d 230 (5th Cir. 1994), is not inconsistent with Jarvis: it addressed an issue not germane to our discussion, namely, whether a law firm could obtain a vacating of an order granting an application *nunc pro tunc* to employ another professional when the order blamed the law firm for the late filing.

employ it as counsel. It may make little sense that a bankruptcy judge has discretion under § 328(c) to allow (or deny) compensation to a law firm whose disinterestedness is discovered only after the application was approved, but no such discretion in the case of a law firm whose application is denied, but as the Seventh Circuit concluded, that is the way the statutory provisions are written. As Judge Massey notes, "there will always be some risk that approval will not be forthcoming with unpleasant consequences for the firm," but that is a cost the law firm should bear in order to permit other parties a fair opportunity to investigate the employment application. In re Smith, supra, at 5. It makes no sense to engage in rushed rulings on applications in order to permit the law firm to gain the advantage of § 328(c) even though an orderly ruling on the application would result in its denial.

If the professional is aware that the application for its employment presents a question that might (or might not) lead to disqualification, the debtor in possession (or trustee) can ask for an emergency determination of that question, and the court can grant an interim determination of that question so that the work can be compensated, if appropriate under § 328(c), despite the later entry of a final determination denying the application. Although, under Rule 6003, the applicant must show that such relief "is necessary to avoid immediate and irreparable harm," and the interim order should be limited to work that is necessary to avoid such harm, that is a reasonable restriction so that interested parties have an adequate opportunity to investigate the application before a final order issues.

Sometimes a real estate broker or other sales agent will decline to perform work until the application for employment is granted, but that may be because the professional fears that the application may be opposed based on the terms of compensation sought to be approved. But if there is a possibility that the terms might not be approved, then that is all the more reason to make sure there is time for objection to the application. Moreover, in true emergency situations (meaning, in the words of the rule, "to the extent that relief is necessary to avoid immediate and irreparable harm)", Rule 6003 permits the time period to be shortened.

Nor do these judges believe that the goal of uniformity in procedures for first day orders may be frustrated by the "immediate and irreparable harm" exception in the rule itself:

- A corporation or a partnership cannot file a petition without an attorney signing the petition. Even an individual chapter 11 debtor who will need the assistance of counsel in the case is

unlikely to file a chapter 11 petition without having an attorney representing her at the outset. An attorney who signed a petition is hardly able to claim that the debtor in possession needs an order authorizing the attorney's employment in order for the debtor to have counsel and avoid "immediate and irreparable harm."

- As a practical matter, experienced chapter 11 debtor in possession counsel understand that if their employment is eventually approved, the approval will relate back to the date of the application for employment (if not earlier). Experienced counsel carefully investigate the issue of disinterestedness before taking on such representation lest they undertake substantial work only to be denied compensation because their application is later denied based on a lack of disinterestedness.

- While there may be other professionals who need to be hired in the case, their role is secondary to that of the debtor in possession's general bankruptcy counsel, and it will be a rare case in which (1) immediate employment, and (2) immediate authorization of such employment is necessary to avoid "immediate and irreparable harm."

In short, these judges do not view the "immediate and irreparable harm" exception as a "loophole" through which uniform application will be frustrated.

In an article written by the Honorable James M. Peck, U.S. Bankruptcy Judge for the Southern District of New York[3], Judge Peck recognized the recent controversy about the retention of professionals, including variation in the way Rule 6003 is being applied, but advocated literal application of the rule rather than amendment. He opined as follows:

> Debtor's professionals routinely are able to perform their duties during the early weeks of a bankruptcy case as "proposed counsel" or as "proposed financial advisors" and thereafter may

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[3] Hon. James M. Peck, "Changes Made to 'First Day' Motion Practice by Bankruptcy Rule 6003", The Association of Commercial Finance Attorneys, Inc., 2008 Continuing Legal Education Weekend, May 15-18, 2008. The article, as well as the transcript of the discussion on Rule 6003 in In re Quebecor World (USA), Inc., Case No. 08-10152, (S.D.N.Y. January 23, 2008) are attached.

obtain orders authorizing employment on a *nunc pro tunc* basis. Rule 6003 is designed to slow things down so that creditors have the time that they need to evaluate all aspects of the case, including the qualifications of the proposed professionals. For this reason, the author advocates literal application of the rule's mandatory language governing "first day" procedure except where it would be inequitable to do so.

II

As to the second proposal of authorizing interim orders, these judges note that Rule 6003 already authorizes an interim or final order sooner than day 21 of the case "to the extent that relief is necessary to avoid immediate and irreparable harm," and believe that the "immediate and irreparable harm" requirement is a reasonable restriction. As discussed in part I, the issuance of an interim order, based on a preliminary determination that employment will be authorized despite a close call regarding disinterestedness, and limited to work that is necessary to avoid immediate and irreparable injury, protects the interests of all.

III

As to the proposal to prevent "gaming" of Rule 6003 that can arise by filing of the application only a few days before day 21 of the case, a professional faces the risks:

> (1) that his work prior to the filing of the application will not be authorized on a *nunc pro tunc* basis if there was no justification for the delay in filing the application,
>
> (2) that the court will not look benignly on the timing of the application in an apparent attempt to circumvent Rule 6003, and
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> (3) that the court would ordinarily insist on interested parties having the usual amount of time provided by Local Bankruptcy Rule to respond to such an application.[4]

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[4] Although the response time generally provided by Local Bankruptcy Rule for an employment application may be less than the 20 days provided by Rule 6003 for a first-day application, the point is that by day 21 of the case the court and interested parties should be in a position that the Local

Accordingly, there is no need to re-write the rule to address such "gaming" of the rule.

Despite its applicability to only the first 20 days of the case, one of the salutary benefits of Rule 6003 is that it should serve to educate the bar that regardless of the stage at which an application to authorize employment of a professional is filed, the delay in entry of an order granting that application does not mean that the professional receives no compensation for services in the limbo period (between filing of the application and the granting of the same). This should serve to discourage emergency applications based on any misperception to the contrary. And it should lead to judges refusing to grant most such applications (including those filed *after* day 20 of the case) unless the applicant gives the United States Trustee and other interested parties the usual time in the district for responding to applications for entry of an order. Accordingly, if an application *is* filed, for example, at day 18 of the case, a judge would ordinarily insist on a response time longer than just 2 days.

CONCLUSION

The BJAG members appreciate the consideration of the Committee on this issue.

Honorable Philip H. Brandt
Honorable Charles Caldwell
Honorable J. Michael Deasy
Honorable Henley Hunter
Honorable Lewis Killian
Honorable Margaret Dee McGarity
Honorable Cecelia Morris
Honorable Michael Romero
Honorable S. Martin Teel, Jr.
Honorable Jerry Venters
Honorable John Waites
Honorable Judith Wizmur, Chair

Bankruptcy Rule response time is sufficient to given them adequate time to respond. If an application is filed, say, at day 18 of the case, and the response time under Local Bankruptcy Rule is 14 days, the application could not be granted until day 33 of the case (unless the response time were shortened for cause).