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Making sense of new Rule 6003: Interim approval of the retention of DIP professionals

By Arthur J. Spector

Debtor's counsel is standing at the lectern prepared to argue a slew of first-day motions for the debtor-in-possession, a corporation or limited liability company. The motions include life-blood issues, such as use of cash collateral or interim DIP financing, and perhaps the doctrine of necessity for essential vendors. The first motion on the calendar is the debtor's application for approval of the employment of its counsel as counsel for the DIP. Recognizing the new Rule 6003 proscription on entering an order granting an application under Rule 2014, the debtor's application is for *interim relief* only. It requests court approval of counsel's employment prior to the 20 days after the petition date, until a final hearing on the application can be convened. It also provides that the entry of the interim order would be without prejudice to the rights of any party-in-interest to interpose an objection to the application, which will be considered *de novo* at the final hearing. The U.S. Trustee stands and objects to the court even hearing the interim application, because, she submits, new Bankruptcy Rule 6003 makes no provision for interim orders.

The new Rule 6003 provides as 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 regarding the following:

(a) an application under Rule 2014;

(b) a motion to use, sell, lease, or otherwise incur an obligation regarding property of the estate, including a motion to pay all or part of a claim that arose before the filing of the petition, but not a motion under Rule 4001; and

(c) a motion to assume or assign an executory contract or unexpired lease in accordance with § 365.

The U.S. Trustee argues that in the plain words of the Rule, a court may not enter an order approving an application for employment before 20 days after the filing date unless the court finds that the failure to do so would cause an "immediate and irreparable harm" to the estate.

How should the debtor — or its prospective counsel — respond?

This new rule, in effect since Dec. 1, 2007 — slightly more than two months — has not, until now, been the subject of any reported decisions. The first case to decide the question of whether a court has the authority to enter an interim order approving the retention of counsel for the DIP was decided from the bench on Jan. 22, 2008, followed by a written order on Jan. 28, 2008, by Judge Paul Hyman of the Southern District of Florida in *In re First NLC Financial Services, LLC*, 2008 WL 268428 (Bankr. S.D. Fla. Jan. 28, 2008).

Utterly impractical

In essence, the debtors' argument was that, as interpreted by the U.S. Trustee, Rule 6003 would be shocking in its utter impracticability. Most Chapter 11 cases are filed by an inanimate entity such as a corporation or limited liability

About the author

Arthur J. Spector is a shareholder of and serves as the team manager for Berger Singerman's Business Reorganization Team. He is resident in the firm's Fort Lauderdale office.

He was a U.S. Bankruptcy Judge in the Eastern District of Michigan for 18 years (1984-2002), where he was Chief Judge the last three years. He authored 170 published judicial opinions, including 25 in *Dow Corning* alone. ■

company. In most states, including Florida, these entities may not lawfully appear in a court without representation by a licensed attorney admitted to practice before that court. Consequently, corporate or LLC debtors are prohibited from arguing the various first-day motions on their own unless some counsel were authorized to act on their behalf at least through the first day.

In addition, in the special circumstance of bankruptcy, counsel may not represent a DIP in a case unless and until its engagement is approved by the court under Bankruptcy Code Section 327(a) ("the debtor-in-possession, *with the court's approval*, may employ ... attorneys."). (Emphasis added.) The converse of that statement is simple. Without the court's approval, the DIP *may not employ* an attorney. Although case law dealing with Section 327(a) most frequently arises in the context of compensation decisions in conjunction with Section 330(a), the requirement of court approval of employment under Section 327(a) stands alone, and is not dependent on the existence of an application for compensation. Therefore, if the U.S. Trustee's absolutist position were adopted, any nonindividual Chapter 11 debtor would have to wait 20 days before its first-day motions of any type could be heard.

The court in *First NLC* agreed that the U.S. Trustee's reading of Rule 6003 was impractical. The court looked to the comments of the Advisory Committee that drafted Rule 6003 and recognized that the committee had pointed to a reasonable way out of the conundrum. The committee's note referred courts to the procedure, well understood and practiced under Rules 4001(b)(2) and 4001(c)(2), that permits interim relief pending the convening of a final hearing (in those cases, 15 days after the filing of the motion). With Rule 4001 as the model, the court in *First NLC* took testimony of the debtor's Chief Restructuring Officer, Thomas J. Allison, of Mesirow Financial LLC, to determine whether the failure to approve the employment of counsel for the DIP would present an immediate and irreparable harm to the estate.

Allison testified that in his extensive experience as CRO of numerous other Chapter 11 debtors, among other positions in Chapter 11 cases, he had never before seen a DIP without counsel in the first 20 days of the case. He further testified that, in his opinion, unless counsel was immediately available to serve the estate, the effects on the estate could be devastating. The court credited Allison's testimony and held that immediate and irreparable harm would result if debtor's counsel's employment were not approved on an interim basis.

N.Y. court finds standard not met

On the very next day, in an oral ruling in New York City, another bankruptcy judge denied interim approval of the employment of Arnold & Porter LLP as counsel for the DIP. *In re Quebecor World (USA), Inc.*, Case No. 08-10152-JMP (Bankr. S.D.N.Y. Jan. 23, 2008).

That court denied the request for interim approval of the law firm's employment because it found that the immediate and irreparable harm standard had not been met in that case. Although the *Quebecor* court was unpersuaded that such harm would result, the court never truly addressed the harm to the estate had Arnold & Porter chosen not to proceed without the court's interim imprimatur. Instead, the court evaluated the anxiety that would be suffered by Arnold & Porter during the 20 days it would have to wait for a final hearing. Nor did the *Quebecor* court consider the issue of Section 327(a)'s requirement that counsel's employment by the DIP be first approved by the court.

While the court in *Quebecor* did not ultimately find the requisite harm to the estate, it nevertheless rejected the U.S. Trustee's argument that a court is powerless to grant interim approval of DIP's counsel's employment. It stated, "I don't think bankruptcy rules are designed to be one size fits

Is interim relief really necessary?

Some may argue that because the court could order full compensation for the prospective DIP's counsel from day 1, even if counsel's employment is unexpectedly not approved, there may be no reason to allow interim relief. Collier suggested as much. See *Collier on Bankruptcy*, ¶ 6003.02[2].

But to accomplish the goal of compensating a professional who labors during the first 20 days of the case only to learn at the final hearing that approval of its employment is denied, the court would have to perform a somersault: first entering an order *approving* the professional's employment back to the petition date, then *allowing the compensation* for the work performed, and then *denying approval* of further employment. This most unwieldy procedural two-step is ill-advised and unnecessary if interim relief à la Rule 4001(b)(2) and (c)(2) is incorporated within Rule 6003. ■

all. I think that even with mandatory language, the wiggle room is there to allow for thoughtful interpretation."

A respected treatise concurs that "nothing in the text of Rule 6003 precludes entry of an interim order," and notes that there are many situations where "the interim and final relief division would work well." *Collier On Bankruptcy*, ¶ 6003.03 (15th Edition Rev. 2007) (*see box, above*).

Southern District of Florida gets it right again

Shortly after the *First NLC* and *Quebecor* cases were decided, another judge in the Southern District of Florida was confronted with the same arguments. Again, the Southern District of Florida interpreted the rule in a practical manner, adopting the decision of the court in *First NLC*. *See In re TOUSA, Inc.*, Case No. 08-10928-JKO (Bankr. S.D. Fla. Jan. 31, 2008).

It is long-standing lore in the bankruptcy world that Congress passes laws, the Supreme Court adopts rules, and the bankruptcy judges and lawyers find a way to make the whole process work. The bankruptcy judges of the Southern District of Florida rose to the occasion in this instance. One may anticipate that the rationale of the *First NLC* decision will be adopted broadly, as it provides a practical, reasonable solution that helps the process move with the efficiency that the constituents of the system expect and commerce requires. ■