

The Purpose and Application (So Far) of New Bankruptcy Rule 6003

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On December 1, 2007, some significant changes to the Federal Rules of Bankruptcy Procedure took effect. Among them is new Bankruptcy Rule 6003, which precludes the granting of certain relief within the first 20 days of a bankruptcy case. Specifically, new Rule 6003 provides:

Rule 6003. Interim and Final Relief Immediately Following the Commencement of the Case – Applications for Employment; Motions for Use, Sale, or Lease of Property; and Motions for Assumption or Assignment of Executory Contracts.

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.

According to the Advisory Committee note, Rule 6003 was intended to pull some matters out of first-day consideration so that the court could focus on the truly urgent matters and parties would have time to weigh in on matters that affected their own interests. As the Advisory Committee Note states:

There can be a flurry of activity during the first days of a bankruptcy case. This activity frequently takes place prior to the formation of a creditors' committee, and it also can include substantial amounts of materials for the court and parties in interest to review and evaluate. This rule is intended to alleviate some of the time pressures present at the start of a case so that full and close consideration can be given to matters that may have a fundamental impact on the case.

Deliberations among the Advisory Committee on Bankruptcy Rules prior to Rule 6003's adoption shed additional light on this intended purpose. One concern that led to Rule 6003 was that debtors' venue decisions were being influenced "by an imbalance in 'first day' practice in some districts." According to the Joint Subcommittee on Venue and Related Matters in Large Chapter 11 Cases, which recommended Rule 6003 to the Advisory Committee, the Rule, along with other amendments, was "intended to reinstate a greater degree of balance among the interests of all parties in the case during the opening stages of the proceedings." The Joint Subcommittee continued:

It can occur that orders entered immediately after the commencement of the case can substantially limit the course the case may take. The courts frequently are presented with voluminous documents that they may not even be able to completely read prior to entering some order in the case. With these actions being taken so quickly, a creditors' committee may not even be formed prior to the court rendering a decision in the matter. Under these amendments, there would be a short breathing spell of twenty days at the start of the case that would provide an opportunity for the United States trustee to appoint a creditors' committee that may also be in a position to have employed professionals to assist it in taking a position on these matters. The rules still provide for expedited relief, but persons seeking that relief have the burden of showing the extraordinary need for the relief just as they do under the existing provisions of Rule 4001.

When Rule 6003 was transmitted to the Supreme Court, the Report of the Judicial Conference reiterated this point: "The proposed rule is designed to alleviate the acute time pressures present at the start of a case so that full and careful consideration can be given to matters that may have a fundamental and long-lasting impact on the case."

Not much is known yet about application of the rule in actual cases. Most of the attention the Rule has garnered has been with respect to professional retention and the perception that Rule 6003 could effectively deprive debtors in possession of the benefit of counsel and the services of other professionals for the first 20 days of the case.

In a recent article, Judge Spector articulates the professionals' concerns, apparently formed mostly from arguments made by the U.S. Trustee in the First NLC Financial Services bankruptcy.¹ There, according to Judge Spector, the U.S. Trustee resisted interim approval of the appointment of counsel and argued that the court should not even be considering the application at hearing because Rule 6003 makes no provision for court approval, interim or final, until 20 post-petition days have passed.

Judge Spector, observing the general rule that artificial entities cannot appear in court *pro se*, concludes that adoption of the U.S. Trustee's position would force chapter 11 debtors "to wait 20 days before its first-day motions of any type could be heard." This same

¹ Arthur J. Spector, *Making Sense of New Rule 6003: Interim Approval of the Retention of DIP Professionals*, BANKRUPTCY COURT DECISIONS WEEKLY NEWS & COMMENT, Feb. 19, 2008.

deprivation-of-counsel argument has been proffered in other cases, including Aloha Airlines, in which the debtor urged the court to consider the consequences to the debtor if it lost its attorneys for 20 days.

Judge Spector and the Aloha Airlines application reflect two related views of Rule 6003. The first is that Rule 6003 does not preclude the court from entering an interim order on the first day of the case approving of the debtor's choice of counsel. The second view is that counsel cannot, or at least might not, perform any services on the debtor's behalf because § 327 of the Bankruptcy Code requires court approval of professionals' employment. This loss of counsel, in turn, implicates Rule 6003's exception because, absent approval, the debtor will suffer "immediate and irreparable harm." Either viewpoint, the argument goes, allows the court to bypass the 20-day waiting period.

An Atlanta bankruptcy court took a different approach in *In re Smith*,² and in doing so, it expressly rejected as "unfounded" the fear that the debtors might be without counsel while the application to employ awaits approval:

It is not unusual in bankruptcy cases pending under Chapters 7 and 11 for an attorney for a trustee to render services that include preparing and filing motions, appearing in court and giving advice about what a trustee should and should not do before the bankruptcy judge enters an order granting the motion of the trustee to employ the attorney. 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. Rather, it has generally been accepted for many years that bankruptcy courts have the authority to retroactively authorize employment of professionals.

Moreover, the court correctly observes that the conditions for approval have nothing to do with the debtor's financial crisis; rather, approval is dependent on disinterestedness and the absence of an interest adverse to the estate, just as compensation is limited to what is reasonable and necessary. The court added: "Although there will always be some risk that approval will not be forthcoming with unpleasant consequences for the firm, that risk and its consequences exist whether the Court considers the matter on day one or day twenty-one."

Curiously, the *Smith* court described Rule 6003's "immediate and irreparable harm" exception as "more suited to professionals other than the trustee's or DIP's primary bankruptcy counsel." The court did not expound on this point and so it's not clear whether the court was thinking of the non-attorney professionals commonly employed in large chapter 11 cases or some unique and pressing matter that could arise in any case. In

² *In re Smith*, No. 08-63990 (Bankr. E.D. Ga. Mar. 17, 2008) (order granting U.S. Trustee's motion to reconsider order approving application by debtor to employ bankruptcy counsel). Hat tip to Scott Riddle and his Georgia Bankruptcy Law Blog (<http://www.georgiabankruptcyblog.com/>) for posting the *Smith* order.

either event, however, the court's discussion of disinterestedness and other requirements apply with equal force to all professionals whose employment must be approved.

Beyond the handful of cases dealing with professional retention, practically nothing is yet known about application of Rule 6003. In Lillian Vernon's motion to pay certain pre-petition claims, for example, it recites a number of cases in which Rule 6003 stood as no obstacle to approval, but it provides no reasoning by any court as to why the motions were approved. Aloha Airlines, which did voice concerns over Rule 6003 as it pertained to counsel, made no mention of the Rule in its first-day motion for approval to pay the pre-petition claims of its outside maintenance contractors. The airline likewise provided no reference to Rule 6003 in its motion for approval of bidding procedures to sell its cargo unit, despite the provision for a break-up fee, which, under the Rule's language, would "incur an obligation regarding property of the estate."

A controversy did emerge over a critical vendor motion in the Allied Van Lines bankruptcy. The debtors sought and received first-day approval to pay "prepetition unimpaired claims." A creditors' committee from another bankruptcy, 360networks, subsequently moved the court to vacate that order arguing that it created a presumption that the debtors' scheme of classifying unimpaired versus impaired creditors was correct and gave the debtors the power to pick and choose favored creditors, providing them with payment in full ahead of plan confirmation. Such classification issues, the 360networks committee argued, belong in the plan confirmation context, not in a first-day order. The 360networks committee also asserted that it received no notice of the first-day motion and, therefore, had no opportunity to be heard, or even to alert the court of its intention to object, before the order was entered. Notably, after it was formed, the Allied Van Lines committee joined the 360networks motion.

Based on the 360networks committee's arguments, it looks like the critical vendor motion to which it objected presented precisely what Rule 6003 was intended to prevent. Thus, the dispute could have provided the presiding judge the opportunity to examine Rule 6003 as applied to the parties' arguments and to issue a decision that might shed more light on the Rule. Alas, the matter was settled.

As with any new statute or rule, we can only speculate about the effects until live controversies emerge that are decided by the courts. The matter of professional retention is likely to be settled first, and if courts follow the reasoning of the *Smith* order, then Rule 6003's goal of reducing the overall volume of first-day matters will have been accomplished with no disruption in the rendering of professional services to the debtor.

Other matters are less predictable. As the *Smith* court observed, Rule 6003 could lead to language about "immediate and irreparable harm" being routinely included in first-day motions. However, Rule 9011 should serve as an effective disincentive to misuse the Rule's exception. In addition, some matters to which Rule 6003, by its plain language, would apply may nevertheless be removed from the Rule's reach if they are included in an approved DIP financing order. Financing orders are governed by Rule 4001, which is expressly excepted from Rule 6003.

It's also possible that Rule 6003 will have a greater impact on prepackaged bankruptcies in which the parties expect the visit to bankruptcy court to be a quick one. The 32-hour bankruptcy of Blue Bird Body Company, for example, might not be possible to duplicate. On the other hand, the very nature of a prepackaged bankruptcy ameliorates the need for Rule 6003 because of the pre-petition involvement of affected parties.

In the end, Rule 6003 shouldn't produce the sort of reaction that has been seen in the context of professional retention (and if it does, we would all do well to remind ourselves that concerns about the Rule could have been raised before it was adopted; only two public comments were actually submitted). Keeping in mind the Rule's purpose of ensuring notice to and consideration by interested parties, it should ultimately prove beneficial to debtors because of the greater protection afforded orders entered after everyone has had a chance to have their say.