

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

-----X

In re : Case No. 10-16564 (AJG)
INSIGHT HEALTH SERVICES : Chapter 11
HOLDINGS CORP., et al.,
Debtors. : Jointly Administered

-----X

**OBJECTION OF THE UNITED STATES TRUSTEE
TO THE RETENTION APPLICATION OF JEFFERIES & COMPANY, INC.
AS INVESTMENT BANKERS AND FINANCIAL ADVISORS
FOR THE DEBTORS AND DEBTORS IN POSSESSION
EFFECTIVE NUNC PRO TUNC TO THE PETITION DATE**

**TO: THE HONORABLE ARTHUR J. GONZALEZ
CHIEF UNITED STATES BANKRUPTCY JUDGE**

TRACY HOPE DAVIS, the United States Trustee for Region 2 (the "United States Trustee"), by and through her counsel, respectfully submits this objection to the retention application of Jefferies & Company, Inc. ("Jefferies") as Investment Bankers and Financial Advisors for the Debtors and Debtors in Possession Effective Nunc Pro Tunc to the Petition Date (the "Application"). In support of the objection, the United States Trustee respectfully alleges as follows:

Background

1. On December 10, 2010, the Debtors filed voluntary petitions pursuant to Chapter 11 of the Bankruptcy Code (ECF No. 1) and a joint pre-packaged plan of reorganization (ECF No. 23). The combined hearing on the disclosure statement and plan

confirmation is scheduled for January 25, 2011 (ECF Nos. 59, 61).

2. On December 13, 2010, the Debtors filed an application to retain Jefferies as their investment banker and financial adviser (ECF No. 38). Among other things, Jefferies' engagement letter (the "Engagement Letter") provides for reimbursement of Jefferies' attorney's fees and expenses of Jefferies' affiliates:

In addition to any fees that may be paid to Jefferies hereunder, whether or not any Transaction occurs, the Company will reimburse Jefferies, promptly upon receipt of an invoice therefor for all reasonable out-of-pocket expenses (including fees and expenses of its counsel reasonably incurred), and the reasonable fees and expenses of any other independent experts retained by Jefferies) incurred by Jefferies and its designated affiliates in connection with the engagement contemplated hereunder; provided, however, that such reimbursable expenses shall not exceed \$75,000 (excluding the fees and expenses of Jefferies['] counsel retained in connection with a Financing) without the Company's prior approval.

(id., Engagement Letter ¶ 5). In addition, the Engagement Letter provides for the indemnification of Jefferies' affiliates, which are not being retained (id. ¶ 6 & Schedule A).

Argument

A. Governing Law

Pursuant to section 327(a) of the Bankruptcy Code a debtor may, subject to court order, retain a professional who is disinterested and does not hold or represent an interest that is adverse to the estate. 11 U.S.C. § 327(a). Further, the debtor may employ the professional "on any reasonable terms and

conditions of employment, including a retainer, on an hourly basis, or on a contingent fee basis." 11 U.S. C. § 328(a).

Section 327(a), however, only provides the minimum requirements which must be met in order to qualify for appointment as a professional. See In re Glosser Bros., Inc., 102 B.R. 38, 39 (Bankr. W.D. Pa. 1989). "[T]he mere fact that a professional satisfies the technical requirements of § 327 does not mandate Court approval." Id. Courts must also consider whether the representation is in the best interest of the debtor's estate. Id.

The burden of proof is on the moving party to establish that "the terms and conditions are in the best interest of the estate." In re Gillett Holdings, Inc., 137 B.R. 452, 455 (Bankr. D. Colo. 1991), quoting In re C & P Auto Transport, Inc., 94 B.R. 682, 686 (Bankr. E.D. Cal. 1988). Accord In re Chas. A. Stevens & Co., 109 B.R. 853, 854 (Bankr. N.D. Ill. 1990).

**B. Attorney's Fees Should Not Be Permitted
As Expenses Of the Debtors' Estates**

Jefferies seeks to charge the Debtors' estates for their legal fees (not in connection with indemnification rights) as an expense of the estates. The Application, however, fails to provide any authority for this position. In fact, such an expense is not permitted in the Southern District of New York. See Blockbuster, Inc., 10-14997(BRL)(order upholding United States Trustee's objection to investment banker's request for

legal fees)(ECF Nos. 23, 283, 372 & 464)). For an attorney to be paid from a debtor's estate, that attorney must be retained under section 327 of the Bankruptcy Code. See In re Crafts Retail Holding Corp., 378 B.R. 44 (Bankr. E.D.N.Y. 2007) (financial advisor precluded, as a matter of law, from being paid the fees of its attorney as a reimbursement of expenses); In re Cenargo Intern., PLC, 294 B.R. 571 (Bankr. S.D.N.Y. 2003) (fees of barristers that debtor's attorney used to assist in English administration proceedings could not be compensated where barristers retention was not approved by the bankruptcy court); see also Drexel Burham Lambert Group, 133 B.R. at 27 (Bankr. S.D.N.Y. 1991) (fees to negotiate a retention are part of an investment banker's overhead and are more than adequately covered by a retention fee).

Aside from Sections 503(b)(4) and 506(b) of the Bankruptcy Code, the United States Trustee knows of no other provision of the Bankruptcy Code that authorizes the award of fees and expenses to non-retained professionals. See Lamie vs. U.S. Trustee, 540 U.S. 526 (2004) ("A debtor's attorney not engaged as provided by §327 is simply not included within the class of persons eligible for compensation."). Moreover, the reimbursement of fees and expenses for retained professionals is governed by section 330 which, generally speaking, focuses on reasonableness and benefit to the estate of the professionals'

services. In re Lederman Enter., Inc., 997 F.2d 1321, 1323 (10th Cir. 1993). Said differently, an application for compensation and reimbursement of expenses must demonstrate that the professional's services were necessary and made a beneficial contribution to the estate or its creditors. In re Engel, 124 F.3d 567, 573 (3d Cir. 1997); see also In re Fibermark, Inc., 349 B.R. 385, 396 (Bankr. D. Vt. 2006) (emphasis added) (Bankruptcy professionals should be compensated "commensurate with their expertise and the benefit their efforts yield to the estate."). In the case of the payment of a professionals' counsel fees and disbursements, there is no direct benefit for the services provided by such counsel directly to the Debtors's estates - the only benefit is to Jefferies. Moreover, such counsel's legal advice to, and on behalf of, Jefferies' interests may at times even be contrary or adverse to the interests of the Debtors.

The Debtors should not be obligated to pay for services that do not benefit the Debtors' estates and that are solely a cost of Jefferies of doing business and being retained as a professional. Such legal services should be regarded simply as Jefferies' "overhead." Accordingly, any request for authority to seek reimbursement of attorney fees (other than in connection with indemnification) should not be permitted.

C. Indemnification of Affiliates and Other Third Parties

Jefferies seeks to have, among others, non-retained affiliates indemnified by the Debtors (ECF No. 38, Engagement Letter ¶ 6 & Schedule A). Jefferies, in essence, seeks to give non-retained affiliates and other non-retained third parties, that have not filed affidavits of disinterestedness and whose disinterestedness Jefferies cannot vouch for, rights without providing any support as to why they are entitled to them. Affiliates and other such entities that do not undergo the formal retention process required by Section 327(a) should not be permitted, and should not receive indemnification from the Debtors. See In re 245 Associates, Inc., 188 B.R. 743, 749 (Bankr. S.D.N.Y. 1995) (a professional cannot receive compensation until the bankruptcy court has authorized that professional's employment); Cf. In re Office Prods. of America, Inc., 136 B.R. 675, 686 (Bankr. W.D. Tex. 1992) ("If the trustee were permitted to circumvent the requirements for § 327 by impliedly assuming a pre-petition executory contract to hire a professional, Section 327 would be eviscerated").

Accordingly, the United States Trustee objects to the indemnification of any entities for any work related to the engagement of Jefferies aside from Jefferies itself.

WHEREFORE, the United States Trustee respectfully requests that the Court deny the Application as requested herein and grant such other and further relief as the Court deems appropriate.

Dated: New York, New York
December 29, 2010

Respectfully Submitted,

TRACY HOPE DAVIS
UNITED STATES TRUSTEE

By: /s/ Serene K. Nakano
SERENE K. NAKANO
Trial Attorney
33 Whitehall Street, 21st Floor
New York, New York 10004
(212) 501-0505