

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE SOUTHERN DISTRICT OF TEXAS  
HOUSTON DIVISION

IN RE: §  
RICHARD JOHN MIRELES, JR. and § CASE NO. 05-34951-H2-13  
ANGELA LYNETTE MIRELES §

**MEMORANDUM OPINION AND ORDER FOR COUNSEL TO APPEAR  
AND SHOW CAUSE WHY SANCTIONS SHOULD NOT BE IMPOSED (doc # 53, 69)**

EMC Mortgage Corporation (“EMC”) filed a motion (docket # 53) to lift the automatic stay on the Debtors’ residence. When the motion was called for hearing, counsel announced that they would submit an agreed order. When the Court reviewed the agreed order that was submitted (docket # 69), the Court noted an obscure sentence in the seven page document that proposed to grant extraordinary and previously undisclosed relief. That provision would elevate EMC’s claim for attorneys’ fees from “secured” to “priority” status and would potentially accelerate payment of EMC’s claim for attorneys’ fees ahead of other creditors who were not signatory to (or even adequately notified of) the proposed order. The Court delayed signing the order to give EMC’s counsel an opportunity to file a memorandum to set out any authority for that proposal. After consideration of the memorandum, the Court declines to sign the proposed form of order because it is procedurally and substantively improper. Further, for reasons set forth in more detail below, the Court orders counsel for EMC and counsel for the Debtors to appear at a hearing on November 14, 2005, at 10:30 a.m. to show cause why the Court should not deny attorney fees related to this motion as a sanction for proposing, without candid disclosure, an agreed order that includes relief not authorized by the Bankruptcy Code. The automatic stay imposed by § 362 of the Bankruptcy Code shall continue in force pending the resolution of these matters.

FACTS

In their proposed form of agreed order, EMC and the Debtors agree (i) that EMC has a mortgage on the Debtors’ residence in Harris County Texas, (ii) that the Debtors are delinquent in payments to EMC (as of the date of the agreed order) in the amount of \$9,275.45, and (iii) that EMC has incurred reasonable attorneys’ fees of \$650 to prosecute the motion to lift stay. The Court assumes that the deed of trust in this case provides that EMC is entitled to include collection costs (reasonable attorneys’ fees) as part of its secured claim.<sup>1</sup>

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<sup>1</sup> EMC asserts this fact in its memorandum of authorities and the Court assumes it to be true, thus assuming the facts most favorable to EMC for purposes of this order.

The proposed form of agreed order states:

ORDERED that ... [t]he Debtor (sic) shall have 30 days to modify her (sic) Chapter 13 Plan to include Movant's post-petition arrears and attorneys' fees and costs ... with \$650.00 to be paid by Trustee as an administrative expense out of the first available funds.

#### THE AUTOMATIC STAY, RELIEF FROM THE STAY, AND EMC'S CLAIM

When a bankruptcy case is filed, Bankruptcy Code § 362 imposes an automatic stay on creditor collection effort, including foreclosure. Section 362(d) provides that, on motion of a creditor, the court must grant relief from the stay "for cause." In its motion, EMC alleged that postpetition failure to make required payments was "cause" to lift the stay.

*In lieu* of adjudicating its demand for relief from the stay when the matter was called for hearing, ECM agreed that the Debtors would be allowed to amend their chapter 13 plan to pay the arrearage, including attorneys' fees, through the trustee in a modified plan. Although that resolution would not necessarily be the resolution that the Court would reach after hearing on the merits, modification of the plan to cure the arrearage on a secured claim is appropriate relief when reached by agreement. Most motions for relief from the stay in this district are resolved by a similar agreement. Modification of a chapter 13 plan to pay arrearage on secured claims is the relief that would be allowed in the Court's standard procedures that have been publicized for several months and are available on the Court's website.<sup>2</sup> Had the order stopped there, the Court would have signed it without hesitation. But in the sentence quoted above, EMC proposes to elevate its attorneys' fee claim from secured status (paid over the plan term) to administrative expense status to be paid ahead of the claims of other creditors,<sup>3</sup> and that result is not authorized in the statute or in reported

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<sup>2</sup> Bankruptcy Code § 1322(b)(2), (c)(1). See also [http://www.txs.uscourts.gov/bkforms/liftstay\\_procedures.pdf](http://www.txs.uscourts.gov/bkforms/liftstay_procedures.pdf).

<sup>3</sup> Administrative expenses (authorized in § 503 and entitled to priority by § 507) get different, and in some ways better, treatment than claims of secured creditors in a chapter 13 case. For example, Bankruptcy Code § 1326(b) provides that claims "of the kind specified in section 507(a)(1)" must be paid "Before or at the time of each payment to creditors under the plan..." Secured claims, by contrast, can be paid over the term of the plan, possibly over 5 years. In addition, administrative expenses get special consideration in chapter 13 cases because a plan (or modified plan) must provide for payment in full of all claims entitled to priority under § 507(a)(2), *see* § 1322(a)(2), § 1325(a)(1). Secured claims, by contrast, can be brought current under a chapter 13 plan with remaining payments made after conclusion of the chapter 13 case and plan. In other fact situations, however, the creditor might prefer to be a secured creditor, as for example, if the creditor is oversecured and there are not enough funds to pay all administrative expenses.

precedent. Counsel for EMC and counsel for the Debtors did not give the Court any indication that they were seeking extension, modification, or reversal of existing law or the establishment of new law. From all appearances, the Debtors and EMC were filing a garden variety order allowing the Debtors to cure payment deficiencies.

Individual creditors are not authorized to determine the classification and treatment of claims by agreed orders resolving insular contested matters. There are two reasons. First, Congress defined by statute the classification and priority of claims; Congress did not give the parties an option to change that scheme by agreed orders in insular contested matters. Second, as a fundamental principle of due process, the multitude of creditors in a case cannot be bound by an agreed order between the debtor and one of the creditors when the other creditors are not parties to the agreement.<sup>4</sup>

Secured claims are governed by § 502. Under the facts of this case, EMC's claim for attorneys' fees is part of its secured claim that is entitled to certain benefits, subject to the limitations, specified in §§ 1322 and 1325 (among others). Payment of administrative expenses is authorized by § 503 and are entitled to priority under § 507(a)(1). Section 507 provides that some priority claims must be paid ahead of others. Congress provided no option to elect between these classifications, and no authority for the parties to agree that EMC's claim (even if it were entitled to priority status) would be paid "out of first funds available" ahead of any other priority claims.<sup>5</sup>

It is clear that EMC's claim for attorneys' fees is not entitled under the statute to priority as an expense of administration of this estate. The statutory requirements are that:

1. The entity must file a request for payment of an administrative expense (section 503(a));
2. There must be notice and a hearing (section 503(b)); and
3. The expense must actually be an administrative expense (with illustrative examples provided in § 503(b)(1) - (6)).

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<sup>4</sup> Whether the classification of claims could be changed from the statutory scheme by litigation in which all parties were joined is a matter not relevant to this case and not addressed here. This does not imply that it can be done, only that the question is not cogent to this decision.

<sup>5</sup> "Thus, where Congress has determined that certain claims are entitled to priority status, as under section 507 of the Code, Congress may also provide for the order of priority among the different types of priority claims, such as by granting first priority to certain specified categories of claims. This legislative ordering of priorities may not be varied by the courts. The result is that a court is not free to determine that a claim qualifying as an administrative expense under the express language of section 503(b) should not share in administrative priority with other expenses or should be subordinate to payment of other administrative expenses.." *Collier on Bankruptcy 15<sup>th</sup> Ed.*, ¶ 503.05[2].

EMC admits in its memorandum<sup>6</sup> that it did not file a separate request for payment of an administrative expense. It argues that including a provision for such treatment in an agreed order is equivalent to application for allowance of the expense. That is clearly incorrect, both from the plain meaning of the statute and from even a casual reading of the treatises and jurisprudence.

Bankruptcy Code § 503(a) states:

An entity may timely file a request for payment of an administrative expense ...

Bankruptcy Code § 503(b) states:

After notice and a hearing, there shall be allowed administrative expenses ...

The leading treatise in the field states:

The “notice and a hearing” standard of section 503(b), although not necessarily requiring an actual hearing if notice is properly given and no objection requiring court adjudication has been interposed, generally requires specific approval of administrative expenses by court order as a condition to allowance.

Many courts recognize that they have an independent duty to scrutinize and rule on administrative expense applications, especially fee applications, even absent objection. For example, a creditor in one case argued that because no party in interest objected to its administrative expense request, its claim must be allowed as requested, suggesting that the court should not participate in the allowance process absent objection. The court held that to accept the creditor’s proposition would be to allow creditors, rather than the court, to determine a claim’s priority status.<sup>7</sup>

In this case, no application was made and no notice of an application for allowance of an administrative expense was given.<sup>8</sup> In addition, there was no request for a hearing on the

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<sup>6</sup> Docket # 73.

<sup>7</sup> *Collier on Bankruptcy, 15<sup>th</sup> Ed.* , ¶ 503.04[2].

<sup>8</sup> EMC argues that because attorneys who are signed up for electronic filing get electronic copies of all documents, the proposed form of order should be treated as notice for allowance of an

administrative expense and the Court was not asked to rule that a hearing was not necessary. Parties in interest did not get advance notice of proposed relief and they did not get an opportunity to object or to be heard. As EMC's memorandum concedes, the Court of Appeals for the Fifth Circuit has held that even filing a proof of claim asserting an administrative expense is insufficient; a request for allowance of the administrative expense must be made.<sup>9</sup> If filing a proof of claim is insufficient, then *a fortiori* it is insufficient merely to mention the classification in a proposed form of agreed order regarding relief from the stay. Clearly, EMC failed to comply with the statute.

In addition EMC is not entitled to payments of its attorneys' fees as an administrative expense because EMC's attorneys' fees are not expenses of administration. In its memorandum, EMC argues that the Bankruptcy Code does not define administrative expenses or limit the kind of expenses that may qualify. EMC is correct.<sup>10</sup> But although the statutory list is illustrative and not exclusive, the Court does not have discretionary authority to decide *ad hoc* how to classify claims. Doing so would alter the Congressional priorities of payment to creditors.<sup>11</sup> "Administrative expense" means an expense of administering the bankruptcy estate. EMC's attorneys' fees are EMC's expenses, not expenses of the estate.

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administrative expense. The Court finds that argument to have no merit. First, the only parties who receive electronic notices are parties who are represented by counsel who are authorized to file pleadings electronically in this district. Parties whose attorneys have not filed pleadings in this case and attorneys (perhaps from other districts) who do not file electronically do not receive notices. Second, the statute requires a "request for payment" not one sentence hidden in 7 pages of agreed order.

<sup>9</sup> *NL Industries Inc. v. GHR Energy Corp.*, 940 f.2d 957 (5<sup>TH</sup> Cir., 1991). See also *Collier on Bankruptcy 15<sup>th</sup> Ed.* ¶ 503.02[1].

<sup>10</sup> See *Collier on Bankruptcy 15<sup>th</sup> Ed.* ¶ 503.05: "Section 503(b) describes six general, nonexclusive categories of claims entitled to administrative expense status ..." But that does not mean that the court can simply classify any claim as an administrative expense. The same authority goes on to state: "These categories ... generally include all costs and expenses incurred by the estate ..." [Emphasis supplied.] EMC's attorneys' fees were incurred by EMC, not by the estate.

<sup>11</sup> See *Collier on Bankruptcy 15<sup>th</sup> Ed.* ¶ 503.05[2].

The statute lists 6 examples of administrative expenses:

1. The actual, necessary costs and expenses of preserving the estate<sup>12</sup> and taxes incurred postpetition by the estate;
2. Compensation of trustees and examiners, compensation for attorneys for trustees, examiners, and creditors' committees, and compensation of attorneys for chapter 13 debtors;
3. Expenses of creditors who file involuntary bankruptcy petitions, creditors who recover property for the estate, creditors who assist in criminal prosecutions relating to the case, creditors and committees that make substantial contributions to the estate, custodians superseded by the bankruptcy case, and committee members;
4. Attorneys' fees for the entities that are entitled to payment under subparagraph (3);
5. Expenses of an indenture trustee; and
6. Certain fees and mileage.

Conspicuously missing from this list are the attorneys' fees of creditors who file motions to lift the stay.

EMC cites *In re DP Partners Ltd. Partnership*, 106 F.3d 667 (5<sup>th</sup> Cir., 1997) for the propositions (i) that prior notice of an administrative expense claim is not required, and (ii) that a creditor's attorneys' fees may be classified as an administrative expense. *DP Partners* is simply not applicable to the facts in this case. In *DP Partners*, the 5<sup>th</sup> Circuit held that a creditor who had filed and had obtained confirmation of a chapter 11 plan that enhanced creditor recovery by more than \$3 million was entitled to payment of its attorneys' fees, as an administrative expense, even though the creditor had no expenses other than the attorneys' fees. The Court held that the creditor could recover its attorneys' fees under subparagraph (4) because the creditor had made a substantial contribution to the estate and therefore was entitled to recover its expenses under paragraph (3). As far as notice is concerned, the 5<sup>th</sup> Circuit merely held that notice (of intent to seek payment of an administrative expense) need not be given before confirmation of a chapter 11 plan if the deadline for the administrative expense application was subsequent to the confirmation date. The creditor in *DP Partners* was in a very different situation from EMC. The creditor in *DP Partners* was included in

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<sup>12</sup> Although EMC's memorandum argues (in paragraph 7) that its attorneys' fees are costs of preserving the estate, it is clear that they are not. The motion was brought to foreclose on property of the estate and to remove that property from the estate, not to preserve the property for the estate. As EMC's motion concedes, no court has ever held in a published opinion that administrative expenses include a secured creditor's attorneys' fees in bringing a motion for relief from the stay to foreclose on property of the estate. *Collier on Bankruptcy* ¶ 503.06[3] states: "...[C]ourts have developed several tests for determining whether a particular claim qualifies for being an actual and necessary cost of preserving the estate. Many courts have stated generally that for a debt to qualify as a necessary preservation expense, the debt must satisfy two requirements: (1) it must have arisen from a transaction with the estate, and (2) it must have benefitted the estate in some demonstrable way."

the illustrative list of entities (subparagraph 3) entitled to reimbursement of administrative expenses. The creditor in *DP Partners* was not a secured creditor seeking relief from the stay. The creditor had put money into the estate, not tried to take collateral out. And finally, the creditor in *DP Partners* filed an application, notice was given, and a hearing was held.

EMC also relies on *In re Exchange Resources Inc.* 214 B.R. 366 (Bankr., Minn. 1997) for the proposition that attorneys' fees in a motion to lift stay can be allowed as an administrative expense. Citation of *Exchange Resources* for that principal is overbroad; it does not stand for that proposition in this case. In *Exchange Resources*, the debtor was an operating entity in chapter 11 and the creditor ("Opus") was the debtor's lessor, not a secured creditor. Opus's right to payment of rent was properly classified as an administrative expense.<sup>13</sup> What the Court held was that attorneys' fees that are derived from and defined as part of an administrative expense are themselves administrative expenses.<sup>14</sup> The landlord in *Exchange Resources* did not seek relief under § 362. The Court specifically held that the administrative expense treatment of part of the attorneys' fees of a lessor was an exception from the general treatment of claims and applied only to that narrow claim.

Finally, EMC relies on *In re Sedona Institute*, 220 B.R. 74 (9<sup>th</sup> Cir. BAP 1998). That case is simply not applicable. EMC has not made a "substantial contribution" to this case. All that EMC has done is to seek to foreclose on property of the estate.

#### CONCLUSION CONCERNING ENTITLEMENT TO TREATMENT OF EMC'S ATTORNEYS' FEES AS AN ADMINISTRATIVE EXPENSE

EMC has not applied for or given notice to creditors of its application for payment of its attorneys' fees as an administrative expense of this case. The statute does not authorize, and no court has ever (in a reported decision) authorized the payment of a secured creditor's attorneys' fees in seeking relief from the stay as administrative expenses of the estate. EMC is not entitled to payment of its attorneys' fees as administrative expense in this case.

#### CONCLUSIONS CONCERNING PROPRIETY OF ATTORNEY CONDUCT

What EMC attempted to do in this case was to get improper priority over other creditors. It tried to elevate its claim for attorneys' fees from status as a secured claim (which could be paid over the term of the amended plan) to status as an administrative expense, which was to be paid "from first funds available." Since no statute authorizes the relief proposed and no reported court decision has ever authorized the relief proposed, the Court questions whether EMC's counsel and

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<sup>13</sup> Rent payable by an operating entity in chapter 11 is the quintessential administrative expense, *Collier on Bankruptcy* ¶ 503.06[6].

<sup>14</sup> The court in *Exchange Resources* also held that the portion of attorneys' fees that were not thus special were not entitled to priority as an administrative expense.

Debtors' counsel genuinely believed that the order that counsel proposed "was warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law."<sup>15</sup>

And EMC's proposal for allowance of its attorneys' fees was not made in an application, on notice, with a hearing, but was simply put in an obscure provision in an agreed order. This suggests, as Judge Isgur stated recently<sup>16</sup> that the parties expected

... [T]hat [the proposed relief] would not be scrutinized by the Court because it was filed as an agreed order. Rather than seeking relief that was within the bounds authorized or permitted by the Bankruptcy Code, [the creditor] sought relief in an agreed order that exceeded the range of relief to which [it] might possibly have been entitled following an adversarial hearing.

The method that counsel used severely challenges the candor and trust that must exist between the bench and bar, especially in these days of excruciating workloads. To meet those workloads, the Court depends on counsel submitting agreed forms of orders to resolve the hundreds of contested matters that each judge hears each week. Perhaps because bankruptcy judges can give only superficial review to agreed orders, or perhaps because clients pressure counsel to obtain extraordinary relief, there is a growing trend for counsel in discrete and insular contested matters to agree to provisions that are not authorized by the Bankruptcy Code and to try to obtain the authority and dignity of a federal court order to bind parties in interest who are not directly involved in the contested matter and do not have reasonable notice of the order. That trend threatens the integrity of the bankruptcy process and public respect for bankruptcy courts. In a similar recent case, Judge Isgur wrote:

. . . . Each of the bankruptcy judges sitting in Houston has a caseload of approximately 5,000 cases. Each year, there are more than 12,000 motions for relief from the automatic stay. Each week, there are approximately 200 agreed orders or default orders issued on motions for relief from the stay. As a consequence of this workload, [a] Bankruptcy Judge must be able to rely on counsel's compliance with FED. R. BANKR. P. 9011. When reviewing an agreed order, the Court should be able to rely on counsel's representation (imposed by FED. R. BANKR. P. 9011) that the contents of the agreed order are warranted by existing law or by a nonfrivolous argument for the extension, modification or reversal of existing law or the establishment of new law. FED. R. BANKR. P. 9011(b)(2), Moreover, the Court

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<sup>15</sup> FRBP 9011 (b)(2).

<sup>16</sup> *In re Rajitha Nair*, Case No. 03-31579, U.S. Bankruptcy Court, SDTX. Judge Isgur's opinion is docket # 87. Judge Werlein's order affirming that order in part, and reversing in part, is docket # 106.

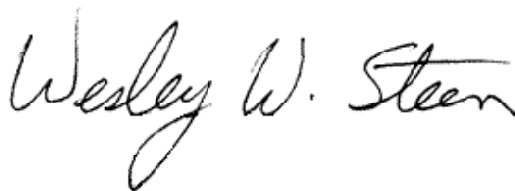
should be able to rely on the representation that the factual contentions have (or are likely to have) evidentiary support. FED. R. BANKR. P. 9011(b)(3).<sup>17</sup>

The Court does not gainsay counsel's right to assert a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law. But to maintain the confidence of the Court and the integrity of the federal judicial process, when counsel seeks cutting edge rulings, counsel must adequately inform the Court that counsel is seeking extraordinary relief. Counsel cannot simply insert a phrase for such extraordinary relief in a seven page agreed order. Counsel must clearly and conspicuously call such a request to the Court's attention. And if other parties are potentially affected, due process requires a contested proceeding involving those parties. The truly unfortunate fact is that the trend in bankruptcy practice has been to use simple motions to lift stay (and other insular contested matters) as an opportunity to reach extensive agreements for which the parties seek the dignity and authority of a federal court order. It is not uncommon to see six to twelve page documents resolving what should be simple termination or continuation of the automatic stay. These extensive agreements, which potentially affect entities not involved in the contested matter, frequently obtain the dignity of federal court orders because the bankruptcy judges can only give the orders cursory review. Client pressures and the natural tendency for attorneys to push the envelope of permissible relief for their clients results in orders that continually expand the scope of the relief that bankruptcy courts are granting without adequate input from potentially adverse parties and without adequate consideration. In this case, counsel have pushed the limits too far.

#### CONCLUSION

In short, the Court believes that the proposed form of agreed order filed by EMC violated FRBP 9011 and violated counsels' duty of candor with the Court. Therefore, counsel for the Debtors and counsel for EMC are ordered to appear before the Court on November 14, 2005, at 10:30 a.m. to show cause why the Court should not deny all attorneys fees related to this motion and order as a sanction for violation of FRBP 9011 and for failure to fulfill counsel's duty of candor to this court.

SIGNED October 14, 2005



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WESLEY W. STEEN  
UNITED STATES BANKRUPTCY JUDGE

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<sup>17</sup> *In re Rajitha Nair*, Case No. 03-31579, U.S. Bankruptcy Court, SDTX. Judge Isgur's opinion is docket # 87. Judge Werlein's order affirming that order in part, and reversing in part, is docket # 106.