

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

IN RE: §
SENSITIVE CARE, INC., § CASE NO. 99-31463-SAF-7
D E B T O R. §

MEMORANDUM OPINION AND ORDER

Sidley Austin Brown & Wood, f/k/a Sidley & Austin, moves the court to determine the value of its retaining lien in certain documents turned over to Robert Milbank, Jr., the Chapter 7 trustee of the bankruptcy estate of Sensitive Care, Inc. Sidley also moves the court to direct that Sidley either receive a cash payment in the full amount of the lien pursuant to 11 U.S.C. § 361(1) or, alternatively, that Sidley receive an administrative expense, under 11 U.S.C. § 503, in the same amount. Milbank opposes the motion. The court conducted an evidentiary hearing on the motion on April 18, 2002.

The determination of an adequate protection payment under § 361(1) or an administrative expense under § 503 constitutes a core matter over which this court has jurisdiction to enter a final order. 28 U.S.C. §§ 157(b)(2)(A), (B) and (O), and 1334.

This memorandum opinion contains that courts findings of fact and conclusions of law. Bankruptcy Rules 7052 and 9014.

Sidley requested to appear at the evidentiary hearing by telephone. The court granted that request. Sidley presented no evidence at the hearing. Rather, Sidley relied on the fee statements attached to the motion and on its argument.

The parties do not dispute that Sensitive Care retained Sidley pre-petition to investigate Medicare claims asserted by the United States against Sensitive Care nursing homes. As of the bankruptcy petition date, Sidley contends that Sensitive Care owed it fees of \$65,435 and expenses of \$10,226.44, for a total claim of \$75,661.44. Sidley had possession of papers belonging to Sensitive Care.

At the request of the trustee, the court ordered that Sidley turn over and disclose the debtor's papers to the trustee. 11 U.S.C. § 542(e). Sidley asserted an attorney's retaining lien on the papers. The court provided ". . .to the extent that [Sidley] has a valid retaining lien, if it does, in any documents copied or turned over, [Milbank] is to compensate [Sidley] by payment or administrative claim for the decrease in value, if any, of such retaining lien, if any, in such documents, as provided in § 361(1), in a total amount to be approved by the Court upon agreement of the parties, or as established by a future hearing before the Court." Order entered July 10, 2001, par. 3. The

order does not recognize a retaining lien. The order does not determine or presume any decrease in value of a lien, let alone entitlement to adequate protection or an administrative expense. The order merely preserved the issue for Sidley to pursue. Absent an agreement of the parties, the order requires that any right to payment and the amount be established at a hearing before the court.

Sidley delivered the debtor's papers to Milbank. Milbank photocopied the papers and returned the originals to Sidley. Sidley has possession of the papers, as it did at the commencement of the bankruptcy case.

Texas law recognizes a so-called retaining lien. "While in his possession, . . . the practicing lawyer has a passive common law lien on papers . . . of the client." Burnett v. Texas, 642 S.W.2d 765, 769 (Tex. Crim. App. 1982). The Texas common law, and not statute, establishes the authority for the lien. "At common law an attorney has a lien for the amount due him for professional services on all papers . . . belonging to his client coming into his possession." Thomson v. Findlater Hardware Co., 156 S.W.301, 303 (Tex. Civ. App.--Austin, 1913). Accordingly, on the petition date, Sidley had a lien on the debtor's papers, in its possession, for its unpaid fees.

The retaining lien survives the filing of the bankruptcy petition, unless the trustee avoids the lien under one of the

trustee's avoiding powers. In re Century Cleaning Services, Inc., 202 B.R. 149, 153 (Bankr. D. Ore. 1996). This motion does not involve an attempt by the trustee to avoid the lien.

Consequently, when Sidley turned over the papers to the trustee, it did so subject to its lien. The trustee photocopied the papers and returned them to Sidley. The trustee acknowledges that he made some use of the information gleaned from the copies of the papers.

Sidley contends that it is entitled to adequate protection under § 361(1) for the trustee's use of the information gleaned from the papers. Under § 361(1), the court may provide adequate protection by "requiring the trustee to make a cash payment . . .to the extent that the . . .use. . .results in a decrease in the value of [Sidley's] interest in such property." 11 U.S.C. § 361(1).

Assuming 11 U.S.C. § 363 applies to the trustee's use of the copies of the papers, the trustee has the burden of proof on the issue of adequate protection. 11 U.S.C. § 363(o)(1).

In Texas, "[a]n attorney's lien on the papers of his client is, however, only a passive lien, and cannot be actively enforced. That is to say, he cannot sell said papers under process to foreclose his lien, as may a pledgee or mortgagee in other cases, but his lien extends only to the right to retain such papers until his debt is paid." Thomson, 156 S.W. at 303.

The attorney may not sell the papers to foreclose the lien. The attorney may only retain the papers until the debt is paid. Burnett, 642 S.W.2d at 769.

On the petition date, Sidley could only hold the papers. Sidley could not foreclose the lien and sell the papers. After the trustee copied and returned the papers, Sidley occupies the same position.

The statutory requirement of a decrease in value connotes value measured in dollars. Thus, for example, had Sidley sought to establish a secured claim based on the retaining lien, the court would be required to determine the value of the lien in lawful currency of the United States as of the date of the filing of the petition. 11 U.S.C. § 502(b). Value would be determined in light of the purpose of the valuation to establish a secured claim. 11 U.S.C. § 506(a). On the petition date, under Texas law, Sidley could not convert its retaining lien to dollars, as it only held a passive lien that could not be foreclosed and sold. The value of the lien has not changed. Sidley still holds the papers and cannot sell them. The retaining lien had no value in dollars on the petition date. Consequently, its value has not decreased. The trustee has effectively established that as a result of Texas law, Sidley is adequately protected. Sidley has not countered that position with evidence showing that it is entitled to the payments authorized by § 361(1).

Courts have held that a trustee's use of the debtor's papers must somehow decrease the value of the retaining lien. See, e.g., In re Life Imaging Corp., 31 B.R. 101, 103 (Bankr. D. Colo. 1983). Those courts have awarded compensation to the attorney for the decrease in value. But, the courts recognize that the decrease in value may be less than the amount of the unpaid fees. In re Garcia, 69 B.R. 522, 524 (Bankr. E.D. Pa. 1987); In re Oiltech, Inc., 38 B.R. 484, 488 (Bankr. D. Nev. 1984). Those published opinions do not include fact findings showing how the courts derived at a decrease in value caused by the trustee's use of the papers.

Whether or not a debtor obtains a discharge of the attorney's fees and whether or not the trustee uses the papers, if the debtor wants the papers back from the attorney, then the debtor must pay the fees. Under Texas law, if the debtor does not want the papers back, then the attorney cannot foreclose and sell the papers. The attorney can only passively hold them.

The trustee's use of the papers has not diminished the debtor's need or desire, if any, to obtain possession of the papers. The trustee concedes that he received some benefit from the use of the papers. However, the trustee returned the papers to Sidley. The trustee cannot quantify the benefit the estate received by his use of the papers. Sidley has offered no evidence of the value that the estate derived from the use of the

papers, let alone how that use decreased the value of the retaining lien supporting an adequate protection payment. The record is devoid of evidence showing any measurable diminishment in value due to the trustee's use of the papers.

The court, therefore, holds that Sidley is not entitled to an adequate protection payment under § 361(1).

Sidley requests, in the alternative, that it be paid its pre-petition claim for unpaid attorneys fees as an administrative expense under § 503. Under § 361, Sidley must recognize that it may not obtain an administrative expense payment for adequate protection. 11 U.S.C. § 361(3). Thus, Sidley's alternative argument must be requesting payment of an actual administrative expense. To state that request is to deny the request. Sidley cannot convert a pre-petition claim, whether it is secured or unsecured, into an administrative expense merely by complying with the requirement of § 542(e).

Courts have held that an attorney's claim for unpaid pre-petition fees may be treated as an administrative expense when the attorney turns over papers subject to a retaining lien to a trustee. See Scroggins v. Powell, Goldstein (In re Kaleidoscope), 15 B.R. 232, 246-47 (Bankr. N.D. Ga. 1981) (A Bankruptcy Act case); In re Matassini, 90 B.R. 508 (Bankr. M.D. Fl. 1988). Those courts, however, do not explain the reasoning used to reach their holdings.

Unpaid legal services provided to a debtor pre-petition constitute a claim against the bankruptcy estate. 11 U.S.C. § 502. Claims existing at the time of the bankruptcy filing do not constitute expenses of administering the bankruptcy estate after the filing of the bankruptcy petition and, therefore, by definition, cannot be administrative expenses. In re T & T Roofing and Sheet Metal, Inc., 156 B.R. 780, 782 (Bankr. N.D. Tex. 1993).

Upon the filing of the bankruptcy petition, a bankruptcy estate is created. 11 U.S.C. § 541(a). Therefore, the debtor's papers in the possession of an attorney become property of the bankruptcy estate. 11 U.S.C. § 541(a)(1). The attorney in possession of property of the bankruptcy estate must turn that property over to the bankruptcy trustee. 11 U.S.C. § 542(e). Failure to turn over the papers would violate the automatic stay, 11 U.S.C. § 362(a)(3), thereby subjecting the attorney, in the case of a corporate debtor, to contempt proceedings. In re First Republic Bank Corp., 113 B.R. 277, 279 (Bankr. N.D. Tex. 1989).

If non-bankruptcy law recognizes a retaining lien for the unpaid fees, then the turn over of the papers to the trustee would be subject to that lien. The attorney could file a proof of secured claim and, if challenged, establish the value of the collateral in lawful currency in the property. 11 U.S.C. §§ 502 and 506(a). If the turn over of the property and subsequent use

of the property causes the value of the collateral to decrease, then the attorney may seek adequate protection. 11 U.S.C. § 361(1). The allowance of a secured claim for the value of the collateral and the award of adequate protection for the decrease in the value of the collateral constitute the Bankruptcy Code's protections for the attorney asserting a retaining lien for unpaid pre-petition services when papers must be turned over to the trustee. Payment of an expense for the administration of the estate under 11 U.S.C. § 503 is not an available remedy. If the attorney cannot establish a value in lawful currency for the retaining lien or if the trustee's use of the property does not result in a measurable decrease in the value, then the attorney does not have an allowable secured claim and/or cannot obtain adequate protection payments. If those remedies are not available because the retaining lien has no value measurable in lawful currency or there has been no decrease in value, then the attorney cannot circumvent the Code to elevate an attorney's pre-petition claim over the claims of other creditors, by obtaining payment of the fees as an administrative expense. This court must, therefore, respectfully disagree with those courts awarding attorneys administrative expenses for the turn over of the debtor's papers.

Sidley argues that the estate received a benefit by the trustee's use of the property. Assuming, for purposes of

complete findings, that Sidley could request payment of its pre-petition fees as administrative expenses because it turned over property of the bankruptcy estate which the trustee used, Sidley would have to meet the criteria for an award of an administrative expense. The Bankruptcy Code provides that "a[n] entity may timely file a request for payment of an administrative expense[.]" 11. U.S.C. § 503(a). Additionally, § 503(b) provides that, "After notice and hearing, there shall be allowed administrative expenses . . . including-(1) (A) the actual, necessary costs and expenses of preserving the estate." 11 U.S.C. § 503(b) (1) (A). Sidley bears the burden of proving that its claim is for "actual, necessary costs and expenses of preserving the estate." In re Transamerican Natural Gas Corp., 978 F.2d 1409, 1416 (5th Cir. 1992). The words "actual" and "necessary" are to be construed narrowly. "[T]he debt must benefit [the] estate and its creditors." NL Indus., Inc., v. GHR Energy Corp., 940 F.2d 957, 966 (5th Cir. 1991). A prima facie case under § 503(b) (1) may be established by evidence that (1) the claim arises from a transaction with the debtor in possession; and (2) the goods or services supplied enhanced the ability of the debtor in possession's business to function as a going concern. Transamerican, 978 F.2d at 1416.

The trustee asserted Medicare payment claims against the United States. The United States asserted claims for Medicare

overpayment and claims under the False Claims Act against the debtor. The trustee acknowledges that some material contained in the papers obtained from Sidley helped the trustee to negotiate a settlement with the United States. The trustee's motion to approve that settlement is pending before this court. But, the trustee cannot quantify any benefit thereby derived from his use of the papers.

Sidley has offered no evidence of any benefit to the estate from the use of the papers. Sidley has merely filed its fee statements, and requested payment of the fees in full. Sidley has failed to meet its burden of proof of a benefit to the estate in any amount of money, let alone a benefit equal to its full pre-petition claim. Accordingly, if the remedy of administrative expense is available, Sidley has failed to meet its burden, and its motion must be denied.

In liquidating bankruptcy estates post-petition, trustees often realize value from an asset derived from goods and services provided to the debtor pre-petition. Providing goods and services to a debtor pre-petition that result in value obtained by a trustee when liquidating assets does not elevate pre-petition claims to administrative expenses. To hold otherwise would undermine the creditor priorities of the Bankruptcy Code.

In its motion, Sidley states "the attorney should be placed in a position comparable to that of any other lienholder entitled

to adequate protection - the value of its lien as of the Petition Date (i.e., the amount of its fees) should be preserved."

Sidley argues, in effect, for an allowed secured claim with adequate protection for a decrease in value. This motion does not involve a claims allowance request. But, in any event, under Texas law, Sidley could not obtain the amount of its fees by any active foreclosure of its lien. The record does not contain evidence of, and Sidley has not shown, any decrease in any value, if any, it could realize. This motion must be denied.

Based on the foregoing,

IT IS ORDERED that the motion is **DENIED**.

Signed this _____ day of May, 2002.

Steven A. Felsenthal
United States Bankruptcy Judge