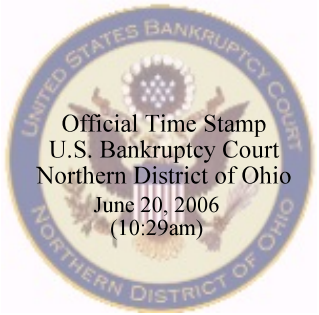
UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:	)	Case No. 06-10375
	)	
DANIEL H. BERGHOFF,	)	Chapter 13
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**MEMORANDUM OF OPINION AND ORDER ON THE COURT'S SHOW CAUSE ORDER ON CENTEX HOME EQUITY CO., LLC**

Centex Home Equity Co., LLC filed a proof of claim in this case which includes attorney fees as a component of the claim amount. After this came to the court's attention at the confirmation hearing, the court issued an order on Centex to show cause why it did not violate bankruptcy rule 9011 by including these fees.[1] *See* FED. R. BANKR. P. 9011. Centex now candidly concedes that its own written policy states that attorney fees should not be included in Ohio proofs of claim and proposes a resolution.

DISCUSSION

Background

On February 28, 2006, Centex filed a proof of claim for a debt which is based on a note secured by a mortgage on real property located at 2049 West 103rd Street, Cleveland, Ohio. *See* claims register, claim #2. The note and mortgage are attached to the proof of claim. The note states that it is governed by Ohio law and is a pre-printed form which includes a provision

[1] Docket 24.

requiring the borrower to pay the lender's expenses, including attorney fees, under certain circumstances.

The proof of claim asserts that the total amount of the claim is $75,899.86, including $5,008.93 in attorney fees. The claim form is signed by Jeremy Briley, a Centex bankruptcy specialist.

Collection of Attorney Fees

Six years ago, this court held that Ohio law prohibits a mortgage creditor from collecting prepetition attorney fees from a debtor-borrower under the circumstances presented here; that is, where the fee terms are set out in a pre-printed form, rather than in a negotiated agreement. *See In re Lake*, 245 B.R. 282 (Bankr. N.D. Ohio 2000). *See also, Dollar Bank v. Petroff (In re Petroff)*, 2001 WL 34041797 (B.A.P. 6th Cir. 2001). Consequently, attorney fees are not an appropriate component of a proof of claim when they are claimed based on such provisions. Despite this, creditors, including this one, continue to include the fees in proofs of claim. "This court has said . . . if a party disagrees with . . . [this] ruling, it is always free to appeal it. What it is not free to do is to ignore it." *In re Payne*, 329 B.R. 815, 819 at n.10 (Bankr. N.D. Ohio 2005).

Bankruptcy Rule 9011

The purpose of bankruptcy rule 9011 is to deter conduct that is injurious to the judicial system and to compensate parties aggrieved by that conduct. *In re Thompson*, 322 B.R. 769, 773 (Bankr. N.D. Ohio 2004). An inquiry under the rule may be initiated either by a party in interest or by the court *sua sponte*. FED. R. BANKR. P. 9011(c)(1). If it appears to the court that a party has violated the rule, the court may:

> . . . enter an order describing the specific conduct that appears to violate subdivision (b) and directing a . . . party to show cause why it has not violated subdivision (b) with respect thereto.

FED. R. BANKR. P. 9011(c)(1)(B).

Subdivision (b) states:

> (b) Representations to the Court. By presenting to the court (whether by signing, filing, submitting, or later advocating) [a] paper, an . . . unrepresented party is certifying that to the best of the person's knowledge, information, and belief, formed after an inquiry reasonable under the circumstances, –
>
> (1) it is not being presented for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation; [and]
>
> (2) the claims, defenses, and other legal contentions therein 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)(1) and (2).

If the court finds a violation of rule 9011, it must impose a sanction. *Jackson v. O'Hara, Ruberg, Osborne and Taylor*, 875 F.2d 1224, 1229 (6th Cir. 1989). The court has wide discretion in determining the sanction, bearing in mind that it is to be limited to "what is sufficient to deter repetition of such conduct or comparable conduct by others similarly situated." FED. R. BANKR. P. 9011(c)(2). The sanction power is to be exercised "with restraint and discretion." *Mapother v. Mapother, P.S.C. v. Cooper (In re Downs)*, 103 F.3d 472, 477 (6th Cir. 1996).

The Hearing Evidence

Jeremy Briley, bankruptcy specialist, and Christine Odom, assistant vice president of the bankruptcy department, appeared at the show cause hearing on behalf of Centex. They gave this testimony: Mr. Briley assumed responsibility for Centex's Ohio bankruptcy portfolio in January 2006. Centex had a written policy in effect at that time (and now) acknowledging that lenders are not entitled to recover their attorney fees in Ohio on standard home loan transactions and those fees should not be included in proofs of claim filed in bankruptcy cases pending in Ohio.

Mr. Briley was aware at some level of the policy, but failed to implement it through inadvertence. The witnesses did not know if Mr. Briley's predecessor had followed the policy.

After receiving the show cause order, Centex addressed the problem and proposes to resolve it by:

(1) providing additional training to individuals preparing proofs of claim;

(2) implementing a procedure where the Ohio proofs of claim are prepared by Mr. Briley and then reviewed by a proof of claim specialist before filing with the court; and

(3) conducting an audit of all Centex proofs of claim filed in open bankruptcy cases in the Northern District of Ohio. If the audit shows that Centex included attorney fees in any such proof of claim, Centex will promptly file an amended proof of claim.

Violation of Rule 9011 and Sanction

Centex violated bankruptcy rule 9011 by filing a proof of claim in this case that contained a claim that was not warranted by existing law. There was no evidence that the violation was willful in the sense that Centex intentionally increased the amount of its proofs of claim or that Mr. Briley benefited financially from doing so. The violation was, however, certainly negligent. The court finds that the proposal offered by Centex to resolve the rule 9011 violation is fair and reasonable and it is approved in principal, with this addition: Centex's filing caused the debtor to incur fees that he would not otherwise have incurred. Under these circumstances, it is equitable that Centex should pay the fees directly connected to the violation, rather than having the debtor bear them.

IT IS, THEREFORE, ORDERED THAT:

On or before **July 7, 2006, Centex is to file a status report in this case with this information:**

(1) the status of the audit of all open cases in the Northern District of Ohio and, if not complete, the number of cases left to review and the amount of time contemplated for that activity;

(2) the case name and number of any case in which Centex discovered an error in its proof of claim;

(3) for any case with an error, the date Centex filed the amended proof of claim or the date on which it anticipates doing so; and

(4) the results of settlement conversations concerning the reasonable attorney fees incurred by the debtor's counsel in addressing this issue.

The court appreciates the forthright manner in which Centex is addressing this problem and suggests it as a model for other creditors who may wish to ensure that they are in compliance with rule 9011 *before* being the subject of a show cause order.

IT IS FURTHER ORDERED that the show cause hearing is adjourned to **July 11, 2006 at 1:30 p.m.** at which time the court will consider Centex's status report. No witness is required to attend the adjourned hearing.

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge