In the United States Bankruptcy Court

for the Northern District of Iowa

HENKE MANUFACTURING CORPORATION	Bankruptcy No. L92-00873W
Debtor.	Chapter 11

ORDER RE: MOTION TO DETERMINE OWNERSHIP OF RETAINER

The matter before the court is the motion of James Michael Green, Karen R. Forrer and William R. Forrer to determine the ownership of $30,000.00 deposited with the law firm of Moyer & Bergman. Hearing was held February 8, 1994, in Cedar Rapids, Iowa.

Findings of Fact

On May 1, 1992, Henke Manufacturing Corporation (HENKE) filed a petition under chapter 11 of the Bankruptcy Code. Henke retained the law firm of Moyer & Bergman to represent it in the bankruptcy. Green was the president and sole shareholder of Henke. Green initiated the contact with Moyer & Bergman on behalf of Henke. He dealt primarily with lawyer Michael McDonough at the firm. McDonough advised Green that the firm would require a retainer of approximately $30,000.00 for representing Henke. McDonough learned that Henke had no unencumbered assets and advised Green that the corporation could not use corporate assets to pay the retainer.

On April 29, 1992, Green's wife, Patricia Green, wrote a personal check on their account to Moyer & Bergman for $10,000.00. Exhibit A. On April 25, 1992, Karen R. Forrer wrote a check on the account of Karen R. and William R. Forrer to Moyer & Bergman for $20,000.00. Exhibit B. William Forrer is Green's first cousin. McDonough never met or talked with the Forrers. The checks were deposited in Moyer & Bergman's client trust account April 30, 1992. On May 1, 1992, McDonough confirmed his firm's agreement to provide legal services to Henke in the bankruptcy proceedings. The letter acknowledged that Green had tendered $30,000.00 toward the firm's fees and stated that the advance "is entirely [the] firm's property." The letter further stated: "Your rights in the payment are

(a) a refund if the advance is not used up and (b) a claim for unreasonable incurrence of fees and expenses. . . ." Exhibit 3. On May 21, 1992, McDonough filed an affidavit stating that the firm had received a $30,000.00 advance toward fees and that the source of the money was "loans to the debtor by its President, J. Michael Green." Exhibit 2.

On October 14, 1992, Green and Jeffrey Casale entered into an option agreement which gave Casale the right to purchase all of Green's stock in Henke. Green and Casale further agreed:

Green shall cooperate with Casale in the development of a Plan of Reorganization for Henke Manufacturing. . . . In his Plan of Reorganization, Casale agrees to provide for the payment, as administrative expenses, of the legal fees of the attorneys hired by Green to represent Henke Manufacturing in connection with the case, subject to approval of such fees as provided in the Bankruptcy Code. To the extent such approved fees have been paid through retainers advanced by Green, Green shall be entitled to reimbursement.

Exhibit C, paragraph A-10. Casale exercised the option sometime in December, 1992.

The schedule of unsecured creditors lists Green as having a claim for $35,400.10. Document no. 28, Schedule F. The scheduled claim is for amounts loaned by Green to Henke unrelated to the $30,000.00 retainer. In negotiations prior to confirmation of the plan, the Unsecured Creditors Committee agreed not to pursue preference claims which it claimed existed against Green and his mother, Rosalie Green, in exchange for Mike Green and Rosalie Green withdrawing their

general unsecured claims and waiving rights to participate in distributions under the plan. Exhibit F. Green agreed to these terms and executed a withdrawal of claim. Exhibit 1.

On June 8, 1993, Henke's plan was confirmed. Exhibit 7. The plan estimated that administrative expense claims, including attorney's fees, would total approximately $50,000.00. On October 15, 1993, the court allowed McDonough's fees and expenses as an administrative expense in the total amount of $50,958.80. There are sufficient assets in the estate, without reference to the retainer, to pay this amount in full.

On November 29, 1993, Green, Karen Forrer and William Forrer filed a motion requesting the court to determine that they are the owners of the $30,000.00 retainer. The Unsecured Creditors Committee objected.

Discussion

In order to prevail, the movants must show that Henke had not acquired an interest in the money as of the date of the bankruptcy petition so that the money did not become property of the estate. 11 U.S.C. 541. Green delivered the money to Moyer & Bergman shortly before the petition was filed. The nature of the transfer determines what interest, if any, Henke had on the date of filing.

Green and the Forrers argue that the money was pledged to Moyer & Bergman to secure Henke's promise to pay attorney fees. They argue the retainer was similar to a surety bond, which would not become property of the estate. See O'Malley Lumber Co. v. Lockard (Matter of Lockard), 884 F.2d 1171,

1176-78 (9th Cir. 1989). The Committee argues that the retainer was a loan by Green to Henke and became property of the estate. "A pledge is a contract for the delivery of personalty, to be retained by the pledgee as security for the performance of some obligation due from the pledgor; the legal title remaining in the pledgor and possession only passing to the pledgee, who has special property in the thing pledged until the obligation secured is satisfied." Nelson v. Commissioner of Internal Revenue, 101 F.2d 568, 571 n.3 (8th Cir. 1939) (citations omitted). "The legal effect of a pledge is to give the pledgee a lien upon the property pledged." Randall v. Colby, 190 F.Supp. 319, 341 (N.D. Iowa 1961). Delivery of the pledged property to the pledgee is the very essence of the contract of pledge. Reyelts v. Feucht, 206 Iowa 1326, 221 N.W. 937, 939 (1928); see also Iowa Code 554.9304(1) (security interest in money can be perfected only by taking possession).

If the money used for the retainer was pledged, it was effective upon transfer. Moyer & Bergman would then have a lien on the money, but Green and the Forrers would retain an ownership interest in it. If the money was a loan, it became property of the estate upon delivery by the lenders to the corporation's representative. The court must examine the intent of the parties at the time of the transfer of the money in order to determine the nature of the transfer. See Sperry v. Clark, 76 Iowa 503, 41 N.W. 203 (1889).

The Forrers did not testify at the hearing. Green testified that Moyer & Bergman told him the retainer would be held as a guarantee in the event there were not enough money in the estate. Green does not claim he has a written agreement with Moyer & Bergman regarding return of the retainer as a pledge. He asserts that his option agreement with Casale indicates the retainer was intended as a pledge. Green understood that Casale would help him recover the retainer through approval of fees in the bankruptcy proceedings.

Attorney McDonough testified that there was no discussion with Green about the return of the retainer if the plan were approved, and no discussion of the retainer as a "guarantee." McDonough testified that after the initial discussion about the necessity of a retainer, Green called him to tell him he had the money. Green asked McDonough how payment would be handled. Although McDonough was unsure of his exact words, he testified that he responded that the transaction needed to be characterized as a loan from Green to the corporation, but the money needed to be disbursed directly to the firm by Green. There is no indication that Green refused to handle the transaction in that manner. Nor is there evidence that upon receiving the retention letter from McDonough (exhibit 3), Green objected to the tenor of the letter which treated the retainer as having come from the corporation. If, at the time the retainer was paid, Green believed McDonough misconceived the nature of the source of the retainer, there is no evidence that he made an effort to disabuse McDonough.

McDonough said there was no discussion regarding recovering the funds until September or October, 1992, when Green negotiated the option agreement. McDonough said he told Green he could make application for repayment of the retainer but did not assure him it would be repaid. McDonough said he told Green his individual claim was beyond the scope of McDonough's representation of Henke.

The court concludes that at the time the retainer was paid to the law firm, Green intended that the source of the retainer was a loan by the individuals to Henke. No one introduced documents signed by Green showing his intent at the time he gave Moyer & Bergman the money. Green has no documents from Moyer & Bergman from that time confirming that the arrangement was a pledge.

Although a mistake or misunderstanding by McDonough would not convert a pledge by movants into a loan, the retainer letter, Exhibit 3, and the affidavit regarding the source of the money, Exhibit 2, corroborate McDonough's testimony that he told Green that the transaction would be structured as a loan, and that he believed it was agreed to by Green. The court believes that any reference to a "guarantee" in the initial discussions regarding the retainer probably was in the context of Moyer & Bergman wanting assurance that it would be paid. No documents created at the time the retainer was given support Green's contention that the retainer was a pledge by movants. The documents which were substantially contemporaneous to the transfer of the retainer support the argument that the retainer was obtained by the corporation through a loan.

The option agreement is evidence of Green's state of mind in October, 1992. However, the agreement with Casale was ineffective to change the earlier understanding regarding the retainer. Green had the ability to structure the retainer as he wanted because he dealt in the matter as an individual and as president of Henke. He has provided little proof that at the time the retainer was paid, it was his intent or the intent of Forrers that the retainer would remain the individuals' property. It may be that Green later decided that there was a different and better way to structure the obtaining of the retainer. And it may be that Green's consideration of other ways was stimulated by his agreement to sell his stock in the corporation. But evidence of later considerations cannot be as persuasive as that surrounding the transaction at the time it took place.

The withdrawal of claim, Exhibit 1, is not determinative of the decision the court has reached. The theory that the retainer was a pledge is not inconsistent with withdrawal of Class 11 claims for unrelated loans to Henke.

It is determined that the $30,000.00 retainer paid to Moyer & Bergman is property of the debtor's estate. Its source was loans from Green and Forrers to Henke. Movants are not entitled to recover the funds. The funds may now be used to pay the professional fees allowed to Moyer & Bergman.

ORDER

IT IS ORDERED that the motion filed by Michael Green, Karen Forrer and William Forrer seeking a recovery of the funds is DENIED.

SO ORDERED ON THIS 3rd DAY OF MARCH, 1994.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order and a judgment by U. S. mail to: