

In the United States Bankruptcy Court

for the Northern District of Iowa

KEARNEY PARTNERSHIP
Debtor(s).

Bankruptcy No. 99-03131-D
Chapter 12

ORDER RE APPLICATION TO EMPLOY COUNSEL AND ORDER RE RETAINER

On December 13, 1999, the above-captioned matter came on for hearing on an Application to Employ Counsel filed by counsel for Debtor. Also set for hearing is an issue concerning the propriety of the retainer taken in this case prepetition. Debtor Kearney Partnership appeared by Attorney Joseph Peiffer. Mercantile Bank appeared by Attorney Eric Lam. Evidence was presented on this issue and the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)A).

STATEMENT OF THE ISSUE

Debtor Partnership filed its Chapter 12 petition on November 29, 1999. Prior to filing the petition, Debtor sought out the services of Attorney Joseph Peiffer. A prepetition retainer in the amount of \$7,500 was paid by the Partnership to Mr. Peiffer. This retainer was disclosed in Debtor's schedules.

During the course of several hearings involving cash collateral and other issues, evidence was presented that Mercantile Bank of Midwest holds a security interest in all of Debtor's property including machinery, feed, supplies, and cattle. The evidence also establishes that in the fall of 1998, Debtor Partnership sold approximately 60 cattle without the consent or permission of secured creditor Mercantile Bank. The amount received for these cattle was in excess of \$31,000. None of these funds were paid to secured creditor Mercantile Bank but were rather placed in a Partnership checking account located in East Dubuque, Illinois. From that time forward, the Partnership used the sale proceeds in this account to pay Partnership expenses. The evidence establishes that two general partners, Don and David Kearney, use the same checking account for their personal expenses. The third general partner, Catherine Kearney, has her own individual checking account also located at the same East Dubuque, Illinois bank.

When Debtor paid Attorney Joseph Peiffer the retainer of \$7,500, the balance in the Partnership checking account was \$5,900. Debtor paid this amount to Mr. Peiffer. The remainder of the retainer was disbursed by general Partner Catherine Kearney who paid Attorney Peiffer \$1,600 from her own checking account.

The evidentiary record establishes that the two Kearney brothers have jobs independently of the Partnership and that certain of their funds may have also been deposited in the Partnership account at the East Dubuque, Illinois Bank. However, the records are so commingled that it is impossible to determine which funds were used for which specific purposes. All that is certain is that at the time of

the payment of Mr. Peiffer's retainer, the entire amount in the checking account was \$5,900 which was paid wholly to Mr. Peiffer. In addition, the Bank records establish that this figure constitutes the lowest intermediate balance in the checking account since the time the cattle proceeds were deposited in that account in the fall of 1998.

CONCLUSIONS OF LAW

The courts in Iowa have consistently followed the "lowest intermediate balance rule".

Under this rule, a secured creditor is entitled to the full amount of the proceeds of its collateral deposited to a commingled fund account if the balance of the account remains at all times equal to or greater than that amount; but if the account balance is at any time reduced below the amount of the deposited proceeds, the creditor cannot recover more than the lowest balance in the account even though deposits thereafter increase the balance of the account.

C & H Farm Service v. Farmers Savings Bank, 449 N.W.2d 866, 877 (Iowa 1989).

CONCLUSIONS

It is obvious that \$5,900 of the retain received by Attorney Peiffer consists entirely or in part of proceeds of the sale of secured collateral. The remaining \$1,600 was appropriately paid from funds which have an independent verifiable source. The appropriateness of that part of the payment is not in dispute. However, the \$5,900 consists of the Partnership account which included proceeds from the inappropriate sale of secured collateral and income generated by two general partners from outside the Partnership. The funds are so commingled with other funds of the Partnership and the general partners that they are completely unidentifiable. When this occurs, the Court looks to the lowest intermediate balance and the secured creditor is entitled to the full amount if the balance of the account remains at all times equal to or greater than that amount. In this case, the lowest intermediate balance was that in the bank account immediately prior to payment of the retainer for Mr. Peiffer in the amount of \$5,900. General partner, Don Kearney, admitted that these funds were used to pay a portion of Mr. Peiffer's retainer. Mr. Peiffer, on the record, expressed his lack of knowledge that the retainer was based in part on funds derived from the sale of secured collateral.

Under the facts and the law, the fund in question is presumptively property of secured creditor Mercantile Bank of Midwest. The payment by the Partnership of these funds in the amount of \$5,900 to Mr. Peiffer was inappropriate. These funds cannot form the basis of a retainer and approval of use of these funds for that purpose must be denied.

WHEREFORE, the Application to Employ Attorney Peiffer as counsel for Debtor is APPROVED IN PART.

FURTHER, the \$1,600 portion of the total retainer derived from independent sources is approved as a partial retainer for Mr. Peiffer's services.

FURTHER, a portion of the retainer in the amount of \$5,900 was derived from commingled funds involving the sale of secured collateral in which Mercantile Bank of Midwest held a perfected security interest. Disbursal of this portion of the retainer is denied.

FURTHER, Debtor is directed to open a debtor-in-possession account and the \$5,900 portion of the retainer inappropriately derived from the sale of secured collateral is to be placed forthwith into that account.

FURTHER, the funds placed in the debtor-in-possession account shall not be disbursed until a hearing is held and appropriate disposition of these funds is determined.

SO ORDERED this 20 day of December, 1999.

Paul J. Kilburg
Chief Bankruptcy Judge