SO ORDERED.

SIGNED this 10 day of February, 2006.

Dale L. Somers
Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In re:	
RAFTER SEVEN RANCHES, L.P.,	**CASE NO. 05-40483**
	CHAPTER 12
DEBTOR.	

MEMORANDUM AND ORDER ADDRESSING MATTERS RELATING TO C.H. BROWN CO.

On the 9th and 10th days of January, 2006, came on for trial the following matters relating to C. H. Brown Co: (1) Debtor's objection to claim of C.H. Brown Co.;[1] and (2) the motion of C. H. Brown Co. to establish a specific date for assumption or rejection of the leases with C.H. Brown Co.[2] The Debtor, Rafter Seven Ranches, L.P. (hereafter "Debtor"), appeared by its attorney, William E. Metcalf, and by its general partner, Michael J. Friesen. Creditor, C. H. Brown, Co. (hereafter "Brown" or "Creditor") appeared by Justice B. King, Fisher, Patterson, Sayler & Smith, LLP, and its president, C.H. Brown III. There were no other appearances.

[1] Doc. 81.

[2] Doc. 55.

This dispute arises out of four prepetition leases (hereafter "Leases") between Brown, as lessor, and the Debtor, as lessee, for the lease of four irrigation sprinkler systems to be installed by Ochs Irrigation (Ochs) on four quarter sections of the Debtor's farm property. The Leases, made in the spring of 2001, are for five years and require semi-annual payments. Debtor made no Lease payments, and Brown filed an unsecured proof of claim for $116,680.00, plus interest and attorneys fees. Debtor objected, asserting that the equipment subject to the Leases was never delivered and Debtor rescinded and repudiated the leases in the fall of 2001. In addition, Brown filed a motion for an order requiring the Debtor to assume or reject the leases pursuant to 11 U.S.C.A. § 365(d)(2).[3] Debtor objected, asserting that the leases were not subject to assumption or rejection. This Court has jurisdiction.[4]

For the reasons stated below, the Court grants the Debtor's objection to claim in part and denies Brown's motion to require assumption or rejection of the leases.

I. FINDINGS OF FACT.

For some period of time prior to April, 2001, Debtor had been discussing with Ochs the purchase of four used tower sprinkler systems for installation on Debtor's farm property.

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[3] This case was filed before October 17, 2005, when most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 become effective. All statutory references to the Bankruptcy Code are to 11 U.S.C.A. §§ 101 - 1330 (2004), unless otherwise specified. Future references in the opinion to the Code shall be to the section only.

[4] Allowance or disallowance of claims and matters pertaining to lease of property are core proceedings. 28 U.S.C.A. 157 (b)(2)(B) & (M). This Court has jurisdiction pursuant to 28 U.S.C.A. § 157(a) and §§ 1334(a) and (b) and the Standing Order of the United States District Court for the District of Kansas that exercised authority conferred by § 157(a) to refer to the District's Bankruptcy judges all matters under the Bankruptcy Code and all proceedings arising under the Code or arising in or related to a case under the Code, effective July 10, 1984. There is no objection to venue or jurisdiction over the parties.

Debtor's general partner, Michael J. Friesen, was an acquaintance of Kenny Ochs, the principle of Ochs' Irrigation, but had never transacted business with him in the past. Mr. Ochs was one of very few dealers selling used sprinkler systems. Mr. Friesen informed Ochs that he wanted four electric systems, newer than 1985, from a soft water area. Mr. Ochs informed Mr. Friesen that he had located the appropriate sprinklers but needed funds before their purchase. At the suggestion of Mr. Ochs, C.H. Brown Co., a private agricultural and equipment lender, was contacted regarding financing. On April 20, 2001, Kenneth Oakes and Michael Friesen flew to Wyoming and met with Mr. Brown of C.H. Brown Co. As a result, Brown agreed to finance Debtor's acquisition of four sprinkler systems to be supplied by Ochs through a finance lease arrangement.

Shortly after the April 20, 2001 meeting, Brown forwarded four Equipment Leases (hereafter "Leases" or "Lease"), one for each sprinkler, to Debtor for execution. Each of the Leases consisted of four separate pages or schedules and was executed on behalf of Debtor on April 20, 2001. The first page is entitled "EQUIPMENT LEASE" and identifies the Lessee as Rafter Seven Ranches, LP, the Supplier as Ochs Irrigation, and the Lessor is C.H. Brown Co. Additionally, the first page of each Lease describes the Leased Equipment by serial number, states the Lease Terms, and references the Lease Payment Amounts (Schedule A), Insurance (Schedule B), and Terms & Conditions of the Lease Agreement (Schedule C). The first page of each Lease contains a block entitled "DELIVERY AND ACCEPTANCE." It recites as follows:

> The undersigned hereby certifies that all the Equipment described in the Equipment Lease is in accordance with the terms of the said Equipment Lease Agreement and has been delivered, inspected, installed, is in good working condition, and has been accepted by the undersigned as satisfactory. The safety decals, labels, etc., if required and supplied, have any affixed to the Equipment as listed

> in said Lease. The undersigned hereby approves payment by C. H. Brown, Co. to the Supplier(s).

This delivery block was separately signed by Debtor and shows the date of delivery to be April 27, 2001. The first page of the Equipment Lease also includes a Personal Guarantee executed by Debtor, also dated April 27, 2001. The Lease Signature blocks on the bottom of the first page of each Lease were executed by Debtor as lessee on April 20, 2001 and by lessor, C.H. Brown, Co., on April 27, 2001.

Schedule A includes the Lease payment terms, which vary only slightly between the four Leases.[5] Each Lease reflects a down payment of $3,000 had been made and requires semi-annual Lease payments for five years. Each Lease provides at the end of the Lease term Debtor can purchase the sprinkler for $2,000, which is 10% of the original equipment cost. Schedule B is an agreement to insure the sprinklers. Schedule C contains terms and conditions, including the following which limit the lessor's warranty liability and reinforces the absolute nature of the lessee's liability:

> 5. WARRANTIES: Lessee agrees that it has selected each item of Equipment, based upon its own judgment, and disclaims any reliance upon any statement of representations made by Lessor. LESSOR MAKES NO WARRANTY WITH RESPECT TO THE EQUIPMENT, EXPRESSED OR IMPLIED, AND LESSOR SPECIFICALLY DISCLAIMS ANY WARRANTY OF MERCHANTABILITY AND OF FITNESS FOR A

[5] Lease R135, for a Valley Sprinkler SN 10978, provides for one payment to seller (Ochs) of $3000, plus 10 semi-annual payments of $2660 each to lessor beginning on November 10, 2001. Lease R136, for a Zimmatic Sprinkler SN 307765, provides for one payment to seller of $3000, plus 10 semi-annual lease payments to Brown of $2696 beginning on December 10, 2001. Lease R137, for a Zimmatic Sprinkler SN 41012606, provides for one payment of $3000, plus 10 semi-annual lease payments of $2725 beginning on January 10, 2002. Lease R138, for a Valley Sprinkler SN 3601070, provides for one payment of $3000, plus 10 semi-annual lease payments of $2756 beginning on February 10, 2002.

> PARTICULAR PURPOSE AND ANY LIABILITY FOR CONSEQUENTIAL DAMAGES ARISING OUT OF THE USE OR THE INABILITY TO USE THE EQUIPMENT. Lessee agrees to make the lease payments required hereunder without regard to the condition of the Equipment and to look only to persons other than Lessor, such as manufacturer, vendor, or supplier thereof, should any item of Equipment for any reason, be defective. . . .
>
> * * *
>
> 21. NET LEASE AND UNCONDITIONAL OBLIGATION. This Lease is a completely net lease, and Lessee's obligation to pay the lease payments and amounts payable by Lessee, under paragraphs 13 and 19, is unconditional and not subject to any abatement, reduction, set off, or defense of any kind.

The Leases provide that they shall be governed by and construed in accordance with Wyoming law. In addition to the Equipment Leases, Debtor and Brown executed UCC-1 financing statements for notification purposes only. They were filed in Kansas.

The Equipment Leases were executed by Erol Klassen, manager of Debtor. Before authorizing the execution, Mr. Friesen had a phone conversation with an employee of Brown regarding the Delivery and Acceptance Certificates. He was informed that it was necessary to execute the Certificates as a precondition to funding of the Leases and therefore directed Mr. Klassen to sign the Certificates, even though the equipment had not been delivered, inspected, or installed. In fact, at the time of execution of the Certificates, Mr. Friesen knew that Ochs had not paid for and did not have possession of the four sprinklers. The Debtor's certification signatures, the guaranty signatures, and lease signatures were affixed on April 20, 2001, and the documentation returned to Brown. The date of delivery lines in the Delivery and Acceptance Certificates and the date lines of the personal guarantees were left blank.

On April 27, 2001, Mr. Brown called Mr. Friesen and inquired whether Debtor was ready to have the Leases funded. Mr. Friesen authorized funding. Mr. Friesen's concern was to get money to Ochs so he could purchase the sprinklers and install them in time for use during the growing season and as close as possible to the corn planting season, which ended May 1. Mr. Friesen testified that during the meeting with Mr. Brown, he learned that Ochs expected to have the units "up and running" within two weeks, but didn't know exactly when the two weeks started, but perhaps it was upon funding.

In response to Mr. Brown's inquiry, Mr. Friesen expressed no preference as to whether the checks should be made payable to Debtor, to Ochs, or to the Debtor and Ochs jointly. Mr. Friesen also expressed no preference as to whether the checks should be mailed to the Debtor or to Ochs. Based upon this phone conversation, Mr. Brown mailed the funding checks totaling $80,000 payable to Ochs directly to Ochs. He understood that Mr. Ochs and Mr. Friesen had made satisfactory arrangements so it was appropriate for Brown to fund the transactions. Mr. Brown viewed Mr. Friesen's authority to fund the Leases as also including authority to fill in the dates on the Delivery and Acceptance Certificates and the personal guaranties. Mr. Brown therefore completed the date of delivery lines and the date of guarantee lines by insertion of "4/27/01."

Shortly after April 27, 2001, Mr. Friesen starting contacting Mr. Ochs to let him know to expect the money and to determine when Ochs received the funding. Although Mr. Ochs was evasive, he kept insisting that he had bought the units. Yet, there was no delivery. During May, Mr. Friesen "knew that he had been had." He contacted the Brown office to ascertain if the money had been paid to Ochs. On July 10, Debtor wrote to Brown, stating in part:

> This is to advise you that Rafter Seven Ranch has not seen the $80,000 you advanced for the purchase of sprinklers, or four operating sprinklers as promised by Mr. Ochs. As of this date we have delayed planting some crops as long as possible. The growing crops are without water, which means they are certain to wither and die under this heat.
>
> * * *
>
> As it is now, we are high and dry. Please give me your thoughts as to what, if anything, I should do.

Mr. Brown testified this was the first notice he received that there was a problem with delivery of the equipment, although it is Mr. Friesen's testimony that he had informed persons in Brown's office on May 5 and thereafter. Upon receipt of the letter, Mr. Brown contacted Mr. Ochs, who made excuses about the failure to deliver.

Later in July, one sprinkler system was delivered and installed by Ochs. The sprinkler did not conform to any of the leases, either in terms of the serial number or the equipment characteristics. Nevertheless, Debtor used the sprinkler to irrigate corn and beans which had been planted before the Lease Agreements were negotiated. Mr. Friesen "harassed" Mr. Ochs to deliver the additional equipment. By letter dated August 15, 2001, from Debtor to Ochs, Mr. Klassen on behalf of Debtor expressed his frustration in part as follows:

> By casual checking, I have learned that apparently you have used the money provided by C. H. Brown and Co. as well as money from Rafter Seven, in an amount exceeding $100,000 for purposes other than the purchase of sprinklers, generators and underground pipe. In other words, it appears that Rafter Seven and/or C. H. Brown Co. may need to recover (from you) more than $50,000. If you have any information to the contrary, it would be greatly appreciated.
>
> In the meantime, it would be my suggestion to Mike [Friesen] that you get ready to make the first annual payments on three sprinklers that aren't delivered or functioning. Additionally, I believe that

> you should provide us with some form of tangible security such as mortgages, titles, or assignments until this matter is cleared.
>
> * * *
>
> Unless I have the written response before August 23, to my home address, 14175 North Mennonite Road, Garden City, Kansas, indicating the location of the sprinklers and generators, we will have to insist on a meeting to arrange a restructuring of your contract with Rafter Seven.

Additional sprinkler equipment was delivered by Ochs to two quarter sections of Debtor's farm property between mid-August and mid-September, 2001. Mr. Friesen testified that he was in the fields when Och's employees arrived and after examination of the equipment, directed that it not be set up. The workers left, but then returned to work on the sprinklers. Mr. Friesen did nothing. Although the equipment was left standing in the fields, it was never completely assembled, and no effort was made to get it functional. During this time, Mr. Friesen "hoped the Kenny [Ochs] would do something responsible."

On November 1, 2001, after Debtor was in default for failure to insure the sprinklers and shortly before the first Lease payment was due, Debtor sent a letter to Brown, which Debtor contends constitutes a rejection of the sprinklers and a repudiation of the Leases. It states as follows:

> As we told Susie on the telephone last month, we have not insured the sprinklers - such as they are. At that time, we mentioned that we might have to reject the sprinklers and repudiate the lease. Nothing has happened since that conversation to change our minds.
>
> At the time of this writing, Mr. Ochs has partially installed one sprinkler. This sprinkler is not 1296 feet long, as promised, nor does it have a generator to provide power to the system. The sprinkler leaks to such an extent that the watering patterns are uneven. Additionally, two tower motors (or gear drives) are worn to the point that they are noisy. This sprinkler was delivered in

> July, after the crops were already stressed. We have tried to mitigate our damages by keeping our production costs low, but that alone did not prevent the yields from being a disaster.
>
> With respect to the other three circles, we can only say that there are no circles with crops underneath them, or operating sprinklers. As this summer became fall, we continued to believe that the two antiquated, dysfunctional systems standing in the weeds would somehow become operational in time to plant wheat crop. They have not. Not only has Rafter Seven lost 390 acres of irrigated row crops, but we have lost the benefit of timely planting the fall wheat. That minimum loss now exceeds the entire lease amount of $80,000. Rafter Seven cannot honor the lease agreement under these circumstances.
>
> We are sorry to take this position and will be willing to work toward another agreement that might resolve this loss.

After receiving the November 1 letter, Mr. Brown phoned Mr. Friesen. Mr. Brown informed Mr. Friesen that the lessor had no responsibility for breach of warranty and that Rafter Seven still owed the Lease payments. Mr. Brown had the sprinklers inspected and made the decision to look to other remedies rather than the return of the leased equipment. At some time, Mr. Friesen obtained estimates to repair the sprinkler delivered in July for about $3,000 and the last two sprinklers delivered for $6,000 to $8,000.

The record is not clear as to contacts between Debtor and Brown other than the correspondence discussed above. Although Mr. Friesen testified that he had numerous phone conversations with personnel from Brown's office inquiring about the whereabouts of the checks sent to Ochs, advising about the non-delivery of the sprinkler systems, and expressing his frustrations concerning the transactions, the testimony did not include specific dates or the specific information conveyed. Mr. Brown testified that before receipt of the November 1, 2001

letter, Brown had received no notice that Debtor intended to reject the sprinklers and had no reason to think that the Debtor would not pay the Leases.

Debtor's testimony as a whole reflects intention to acquire used irrigation systems, even if that required accepting late delivery or some nonconformities. Debtor requested that Brown provide financing for Ochs to supply the sprinklers because Ochs was the only dealer who would provide used systems. Debtor agreed to execute the Delivery and Acceptance Certificates even though the sprinklers had not been delivered because execution was a necessary prerequisite to funding. Debtor used the sprinkler delivered in July even though it was too short and had other problems because he wanted to salvage his planted crops. Mr. Friesen's phone calls to Brown were directed to assuring that Ochs had been paid and frustrations regarding delivery delays. As stated in correspondence and in testimony, Debtor continued to believe during the summer that the sprinklers would become operational. Debtor's letter purportedly rejecting the goods and repudiating the Leases was not sent until Debtor's failure to insure had become an issue and Lease payments were soon due. Even after attempting to reject the sprinklers, Debtor was focused upon hiring a third party to make the delivered units operational and recovery of damages. By letter dated November 23, 2001, Debtor corresponded with Mr. Ochs regarding the situation. The letter stated as follows:

> As you know, Rafter Seven Ranches, L P, has repudiated its lease agreement with C. H. Brown Co. The obvious reason was the failure of consideration, in that there was no performance on behalf of the lessee because the contracts (which were designated as true leases) were not fulfilled in a timely manner. As a result, Rafter Seven completely lost the production on three circles and suffered substantial losses on the fourth. A conservative loss estimate is $20,000-$25,000 per quarter. In other words, the failure of Rafter Seven to receive four sprinklers, (1985 or newer) 1296 feet long, in working order, so that irrigated crops could be planted and insured

> has caused us the value of the entire lease. This does not include approximately $25,000 in cash advances paid by Rafter Seven. It now appears that Rafter Seven will lose its FSA cost share grant unless the installation on the home quarter is completed within thirty days.
>
> I have, of course, been in touch with Mr. Brown, who indicated that we would be contacting him with a date for a conference telephone call - - which I assume to be an attempt to resolve this problem. I have not heard from you in this regard, therefore let me suggest the following approach: since you guaranteed payment of this indebtedness, I have enclosed a payment notification form and self-addressed envelope to the Brown Co. for the first payment. There will be seven more of similar amounts in the next 12 months. You can probably absorb these, but I'm sure that Mr. Brown would like this confirmed.
>
> I anticipate that Mr. Brown will want a new agreement. Rafter Seven will want a release and some idea about repayment, restitution or presentment of four generators and a fourth sprinkler. Mr. Brown and I both agree that if you can not perform, as I just suggested, that you advise him promptly with the written answer to this question: "where is the money?" or "what happened to Mr. Brown's $80,000?"
>
> I will proceed to further mitigate Rafter Seven's damages by hiring other contractors to move or modify the existing systems to try to make them operate and I will attempt to purchase another system, be it new or used. These additional costs should not be those of Rafter Seven so you should be advised that some recompense will be sought.

At no time did Debtor inform Brown that the sprinklers could be picked up or were being held for Brown's account.

After demand letters for payment of the amounts owed under the Leases were not productive, Brown filed suit in the District Court of the County of Platte, Wyoming on July 29, 2003, against the Debtor and Mr. Ochs, d/b/a Ochs Irrigation. The complaint alleges breach of contract and unjust enrichment causes of action to recover the payments which were due under

the Leases, plus interest, attorneys fees, and court costs. The Debtor answered and asserted a counterclaim against Brown for breach of contract, breach of warranty, statutory penalties, and damages in excess of $75,000 and against Mr. Ochs for fraud. A default judgment was entered against Mr. Ochs in favor of Brown. The filing of this bankruptcy stayed the action as to the Debtor.

II. ANALYSIS.

A. C.H. BROWN CO. IS THE HOLDER OF AN UNSECURED CLAIM.

Brown's proof of claim is for Lease payments of $116,680, plus interest at 10% from the date of each semi-annual payment required but not made, plus attorneys fees. Whether Debtor owed this amount on the date of filing is determined by state law. The parties elected in the Leases to have Wyoming law govern the Leases and their construction.

The parties agree that the Leases are finance leases, as defined by section 2A-103(g) of Article 2A of the Uniform Commercial Code (UCC),[6] which had been adopted in Wyoming.[7] A finance lease is a three party transaction which has characteristics of a lease and a loan. The supplier, in this case Ochs Irrigation Equipment, manufactures or supplies the goods pursuant to the lessee's specification. After the prospective finance lease is negotiated, a purchase order is entered into by the lessor, here C.H. Brown, with the supplier. The lessor and lessee, here the Debtor, enter into a lease of the goods. The lessor advances the funds to purchase goods, and the

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[6] U.C.C. 2A-103(g)(1990).

[7] Wy. Stat. Ann. § 34.1-2.A-101, *et.seq.* Wyoming has not adopted nonuniform amendments, except to sections 507(1) (proof of market rent), 524(1) (lessor's right to identify goods to the lease contract), and 529(5) (lessors damages if not entitled to rent), which are not relevant to this case. Accordingly, citations are to the 1990 version of the uniform code, rather that the Wyoming statutory enactment.

lessee pays over time in accord with the terms of the finance lease. Because the lessor provides only financing and the goods are supplied to the specifications of the lessee, Article 2A provides that except when the finance lease is a consumer lease, the lessee's promises under the contract generally become irrevocable and independent upon acceptance of the goods.[8]

Acceptance is the first step in determining liability. Acceptance can occur in either of two ways: The lessee may act in a manner that signifies acceptance; or the lessee may fail to effectively reject the goods.[9] Acceptance is defined by 2A–515 as follows:

> **Acceptance of Goods.** (1) Acceptance of goods occurs after the lessee has had a reasonable opportunity to inspect the goods; and
> (a) the lessee signifies or acts with respect to the goods in a manner that signifies to the lessor or the supplier that the goods are conforming or that the lessee will take or retain them in spite of their nonconformity; or
> (b) the lessee fails to make an effective rejection of the goods (2A-509(2)).[10]

The requirements for an effective rejection of goods are included in 2A-509, the code section addressing the lessee's rights on improper delivery. It states:

> **Lessee's Rights on Improper Delivery; Rightful Rejection.** (1) subject to the provisions of 2A-510 on default in installment lease contracts, if the goods or the tender or delivery fail in any respect to confirm to the lease contract, the lessee may reject or accept the goods or accept any commercial unit or units and reject the rest of the goods.
> (2) Rejection of goods is ineffective unless it is within a reasonable time after tender or delivery of the goods and the lessee seasonably notifies the lessor.[11]

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[8] U.C.C. 2A-407.

[9] U.C.C. 2A-515.

[10] U.C.C. 2A-515.

[11] U.C.C. 2A-509.

A reasonable time is defined by the code as follows:

> **Time; reasonable time; "seasonably".** (a) Whenever this act . . . requires any action to be taken within a reasonable time, any time which is not manifestly unreasonable may be fixed by agreement.
> (2) What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action.
> (3) An action is taken "seasonably" when it is taken at or within the time agreed or if no time is agreed at or within a reasonable time.[12]

Rightful rejection of goods in the lessee's possession imposes upon the lessee the duty to hold them "with reasonable care at the lessor's or the supplier's disposition for a reasonable time after the lessee's seasonable notification of rejection."[13] If the supplier or lessor fails to give instructions within a reasonable time after rejection, the lessee may store or dispose of the goods for the lessor's or supplier's account or ship the goods to the lessor or supplier.[14]

Brown contends that the four sprinklers which were the subject of the Leases were accepted because of the completion of the Delivery and Acceptance Certificates included in each Lease. Those certificates, signed by the Debtor, stated that the four sprinklers conformed to the Leases, had been delivered, inspected, and installed, were in good working order, and had been accepted as satisfactory. Brown relies upon a Texas case where the court found consideration for a lease of a copy machine where the lessee signed an acceptance certificate even though the equipment had never been delivered.[15] The court stated, "The consideration for the lease was not

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[12] Wy. Stat. Ann. § 34.1-1-204.

[13] U.C.C. 2A-512(1)(a).

[14] U.C.C. 2A-512(1)(b).

[15] *Stewart v. United States Leasing Corp.*, 792 S.W.2d 288 (Tex. App. 1985).

delivery of the copy machine but, instead, was [the lessor's] purchase of the copy machine following receipt of the Signed Acceptance Certificate."[16]

The Court rejects this position. The case relied upon by Brown was decided before Texas adopted Article 2A. Article 2A provides that goods are not accepted until there is a reasonable opportunity to inspect, and courts have followed the UCC. Cases confirm that an opportunity to inspect is required before there can be an acceptance.[17] "Taking possession of the goods is not determinative of acceptance, nor is the signing of a form acceptance before receipt of the goods, nor the making of a lease payment."[18] In a case similar to this, the Hawaii Intermediate Court of Appeals held where there was no delivery and therefore no opportunity to inspect the goods, the lessee was not liable for rent, even though an acceptance certificate had been signed.[19] In doing so, the Hawaii court distinguished the case relied upon by Brown and found it contrary to other cases.

Mr. Brown's completion of the certificates on April 27, 2001, based upon directions to issue the checks to Ochs, did not as a matter of law constitute acceptance, even though reliance may have been placed upon a mistaken conclusion that the goods were delivered. The code is

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[16] *Id.*, 792 S.W.2d at 290.

[17] *E.g., Info. Leasing Corp. v. GRD Inv., Inc.*, 152 Ohio App. 3d. 260, 787 N.E.2d 652 (2003) (holding finance leases are subject to defense of lack of acceptance, which requires an opportunity to inspect); and *Gen. Elec. Capital Corp. v. Nat'l Tractor Trailer School, Inc.*, 175 Misc.2d 20, 667 N.Y.S.2d 614 (1997) (holding acceptance did not occur at delivery despite a lease provision that goods were accepted upon delivery, because enforcement of the provision would eliminate any remedy under the lease).

[18] *Colonial Pacific Leasing Corp. v. J.W.C.J.R. Corp.*, 365 Utah Adv. Rep. 27, 977 P.2d 541, 545 (1999).

[19] *JAZ, INC. v. Foley*, 104 Haw. 148, 85 P.3d 1099 (2004).

clear; it requires an actual opportunity to inspect. There is no evidence that Debtor had an opportunity to inspect before delivery. Delivery, assembly, and installation of one sprinkler was in July, 2001. Delivery and partial assembly of two additional systems took place sometime between mid-August and mid-September. There was no attempted delivery with respect to the fourth Lease. The Court rejects Brown's argument based upon the Delivery and Acceptance Certificates that there was acceptance of the goods which were the subject to the four Leases.

The Court likewise rejects the Debtor's contention that as a matter of law there was no acceptance of any sprinklers because none of the delivered goods conformed to the Lease descriptions. Article 2A does not require perfect tender of the goods. Article 2A provides that the lessee may accept nonconforming goods when, after a reasonable opportunity to inspect, the lessee either indicates intent to retain the goods or fails to make an effective rejection. To determine whether any of the goods described in the Leases were accepted, thereby triggering the Debtor's liability for lease payments, the Court must examine the circumstances of performance of each Lease.

Based upon this examination, the Court finds that the Debtor accepted three of the four sprinkler systems. In July 2001, one system was delivered and installed. Debtor had an opportunity to inspect. Although the system did not have a serial number matching any of the Leases, was too short, and had other deficiencies, the Debtor elected to use the sprinkler for his 2001 crops. By using the sprinkler, Debtor acted in a way unequivocally indicating intent to retain the goods despite any nonconformity, thereby satisfying the first of the two alternative

means of acceptance under Article 2A.[20] The goods subject to one of the Leases were accepted in July.

Mr. Friesen testified that two irrigation systems were delivered and partially assembled on two of the quarter sections to be irrigated after August 15 and by about mid-September.[21] Debtor's conduct with respect to these two units was not sufficient to avoid acceptance. First, acceptance occurred because after having a reasonable opportunity to inspect, Debtor acted with respect to the two sprinklers in a manner which indicated he would retain the sprinklers despite the nonconformity. Debtor testified that he was in the field when Ochs delivered the second and third systems and immediately advised that they were unacceptable. But, Debtor's subsequent actions evidence that Debtor was not ready "to pull the trigger"and reject the two sprinklers but rather decided to retain the systems despite their nonconformity. In a letter Debtor wrote Brown on November 1, 2001, it is stated that by phone call in October Brown had been informed that Debtor *might* need to reject, not that he was rejecting. That letter further states that throughout the summer "we continued to believe that the two antiquated, dysfunctional systems standing in the weeds would somehow become operational in time to plant wheat." Debtor wrote to Ochs on November 23 stating that arrangements needed to be made for "repayment, restitution or presentment of four generators and a fourth sprinkler." If the two sprinklers which had been delivered in the late summer had been rejected, arrangements would have been needed for three

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[20] *See Canon Fin. Serv., Inc. v. Medico Stationary Serv., Inc.*, 300 A.D.2d 66, 751 N.Y.S.2d 194 (2002) (lessee obligated to pay rent where leased copier where lessee continued to use if for 8 months before giving notice it wanted it removed from premises).

[21] An August 15th letter to Mr. Ochs from Debtor indicates they had not been delivered as of that date.

sprinklers, but not a fourth sprinkler. That same letter states that Debtor will hire "other contractors to move or modify the existing . . . systems to try to make them operate." By this action Debtor signified intent to retain the two sprinklers delivered in August or September despite their nonconformity, thereby satisfying the first of the two alternative means of establishing acceptance.

Further, the Court finds the that Debtor did not effectively reject the two sprinklers delivered in the late summer, thereby establishing the second means of acceptance. An effective rejection must be made within a reasonable time after inspection, and notice of rejection must be seasonably conveyed to the lessor. The Article 2A provision regarding acceptance is patterned after a similar provision in Article 2, which governs sales. Under Article 2, "Seasonable notice of rejection, . . . requires that a buyer give the seller clear and unambiguous notice of his rejection within a reasonable time."[22] Debtor relies upon the November 1, 2001, letter to Brown as notice of rejection. The Court finds that letter ambiguous, rather than clear and unambiguous. Although the letter discusses nonconformities of the sprinkler delivered in July and the two partially assembled systems delivered in the late summer, the focus of the letter is upon the losses allegedly suffered because Ochs did not deliver sprinklers conforming to the Leases. The $80,000 principal advanced under the Leases is compared with the alleged loss, leading to the conclusion that Debtor cannot "honor . . . [the Leases] under these circumstances." Debtor's actions are consistent with giving notice of loss, rather than conveying a firm decision that the Debtor would no longer attempt to make the equipment usable. There is no suggestion the sprinklers will be held for the account of Ochs or Brown. After the November 1 letter, Mr.

[22] *Elec. Power Sys., Inc. v. Argo Int'l Corp.*, 864 F. Supp. 1080, 1084 (D.N.D. Okla. 1994).

Friesen by letter dated November 23, 2001 clarified his intent when advising Ochs that he would hire other contractors to make the sprinklers work.

Further, notice of rejection is effective only when seasonably given to the lessor. Debtor testified that he rejected the late summer tenders upon delivery. Assuming intent to reject rather than to retain the nonconforming goods, Mr. Friesen gave immediate notice to Och's employees, but delayed giving notice to Brown until November 1. Article 2A requires that notice to the lessor be "seasonable." Here the Leases do not define when such notice must be given, so the UCC controls. It provides seasonable notice is notice given within a reasonable time. The court determines reasonable time based upon the nature, purpose, and circumstances of the action. In cases under Article 2, courts have held that notice of rejection was not seasonable when made approximately one month after delivery[23] and over two months after delivery on approval.[24] Under the circumstances of this case, the delay of approximately two months after Debtor knew that goods were nonconforming was too long. Since early May, Debtor had complained to Brown employees about Och's performance, but had consistently stopped short of saying that the goods were rejected. Given the troubled history of the Leases, Brown was entitled to prompt notice of rejection so performance could be demanded from Ochs as soon as Debtor determined that it would not accept the goods despite their nonconformities. If Debtor had earlier advised Brown, it is possible that Brown might have been able to take action against Ochs which would have rectified the situation. Instead, Debtor did not want to give up the systems he had received

[23] *Pioneer Peat, Inc. v. Quality Grassing & Serv., Inc.*, 653 N.W.2d 469 (Minn. App. 2002).

[24] *Valley Bank and Trust Co. v. Gerber*, 526 P.2d 1121 (Utah 1974).

despite their clear nonconformity. He was hoping that something would happen that would make them work.

For the foregoing reasons, Debtor accepted that sprinklers delivered in August or September. Debtor acted in a manner indicating it would retain the sprinklers despite their nonconformity, and did not give Brown unambiguous notice of rejection in the November 1 letter. In addition, if the November 1 letter had been sufficient to constitute notice of rejection, it was nevertheless not seasonable notice to Brown.

There is no evidence that Ochs made any delivery pursuant the fourth Lease. A reasonable opportunity to inspect is a prerequisite to liability of the lessee under a finance lease. As to one of the Leases, Debtor had no such opportunity and therefor has no liability.

The Court therefore finds the Debtor accepted three of the four sprinkler systems. Acceptance triggered the Debtor's obligations under the three Leases. Article 2A provides:

> **Irrevocable Promises: Finance Leases.** (1) In the case of a finance lease that is not a consumer lease, the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods.
> (2) A promise that has become irrevocable and independent under subsection (1):
> (a) Is effective and enforceable between the parties, . . .; and
> (b) is not subject to cancellation, termination, modification, repudiation, excuse, or substitution without the consent of the party to whom the promise runs.[25]

[25] U.C.C. 2A-407.

The provisions of the foregoing section are subject only to the obligation of good faith and the lessee's revocation of acceptance.[26] The effect of acceptance is further addressed in Article 2A as follows:

> **Effect of Acceptance of Goods; Notice of Default; Burden of Establishing Default After Acceptance; Notice of Claim or Litigation to Person Answerable Over.** (1) A lessee must pay rent for any goods accepted in accordance with the lease contract, with due allowance for goods rightfully rejected or not delivered. (2) A lessee's acceptance of goods precludes rejection of the goods accepted. In the case of a finance lease, if made with knowledge of a nonconformity, acceptance cannot be revoked because of it . . .[27]

Pursuant to the forgoing, in a finance lease, acceptance of the goods with the knowledge of the nonconformity precludes revocation of acceptance.[28] The only basis for a lessee in a finance lease to revoke acceptance is when the lessee's acceptance was without discovery of the nonconformity and the acceptance was reasonably induced by the lessor's assurances.[29]

In this case, Debtor accepted three sprinklers, and the Lease obligations became irrevocable because none of limited defenses are present. Debtor does not assert lack of good faith. Debtor testified that material nonconformities were apparent when the sprinklers were delivered, thereby precluding revocation of acceptance.[30]

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[26] U.C.C. 2A-407, Official U.C.C. Comment, ¶ 1 (1990). The comment cites 2A-103(4) as to good faith and 2A-517 as to revocation of acceptance.

[27] U.C.C. 2A-516.

[28] U.C.C. 2A-516(2).

[29] U.C.C. 2A-516, Official U.C.C. Comment, ¶ 1 (1990).

[30] U.C.C. 2A-516.

Contrary to Debtor's arguments, Brown has no liability for the failure of the sprinklers to work properly. In a finance lease transaction, no implied warranties of merchantability or fitness for a particular use arise.[31] Express warranties need not be made, and all warranties, express and implied, may be excluded or limited by contract.[32] The Leases include the following exclusion of warranties:

> 5. WARRANTIES. Lessee agrees that it has selected each item of Equipment, based upon its own judgment, and disclaims any reliance upon any statement of representations made by Lessor. LESSOR MAKES NO WARRANTY WITH RESPECT TO THE EQUIPMENT, EXPRESS OR IMPLIED, AND LESSOR SPECIFICALLY DISCLAIMS ANY WARRANTY OF MERCHANTABILITY AND OF FITNESS FOR A PARTICULAR PURPOSE AND ANY LIABILITY FOR CONSEQUENTIAL DAMAGES ARISING OUT OF THE USE OR THE INABILITY TO USE THE EQUIPMENT. . .. Lessee agrees to make the lease payments required hereunder without regard to the condition of the Equipment and to look only to persons other than Lessor, such as manufacturer, vendor, or supplier thereof, should any item of Equipment for any reason, be defective. . . .. Supplier is not an agent of Lessor, and Lessee shall have no right to rely on statements or representations presumably made by supplier to Lessor. Lessor assumes no responsibility for the installation, adjustment, or servicing of the Equipment.

Debtor provides no facts and no legal theory why the written exclusions of warranties and the unambiguous statement of the lessee's liability should not be enforced. After acceptance of the three sprinklers, the nonconformities became irrelevant to Debtor's obligation to pay rent.

The warranty provisions of the UCC which render the foregoing provisions of the Leases enforceable, combined with those restricting the right to revoke acceptance, "make the lessee's

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[31] U.C.C. 2A-212 & 213.

[32] U.C.C. 2A-214.

obligations to the lessor survive no matter what - come hell or high water," requiring the lessee to make rent payments to the lessor even if the equipment is unsuitable, defective, or destroyed.[33] This aspect of the transactions is included in the Terms and Conditions, paragraph 21, which states that the lessee's obligations for the lease payments "is unconditional and not subject to any abatement, reduction, setoff, or defense of any kind." Once the goods were accepted, Debtor was bound by the Leases, and failure to make the Lease payments constituted default.[34]

If the lessee fails to make a payment when due or repudiates, the lessee is in default, and the lessor may exercise its remedies, as stated in 2A–523. The remedies include the exercise of the rights and remedies provided in the lease contract. The Leases between Brown and the Debtor include the following regarding remedies:

> 19. REMEDIES. Lessor and Lessee agree that Lessor's damages suffered by reason of an Event of Default . . . are uncertain and not capable of exact measurement at the time this Lease Agreement is executed because the value of the Equipment at the expiration of this Leased Agreement is uncertain. Therefore, they agree that for purposes of this paragraph (19), "Lessor's Loss" as of any given date shall be the sum of the following: (a) the amount of all unpaid lease payments or other amounts payable by Lessee, hereunder, due but unpaid at the date of such payment; plus (b) the amount of all unpaid lease payments, for the balance of the term of this Lease Agreement, not yet due to the time of such payment discounted from the respective dates, installment payments would be at the rate of 10% per annum; (c) compensation for loss of Lessor's anticipated residual value . . .. However, Lessor may recover Lessor's Loss from Lessee in any such action without having to repossess and dispose of the Equipment, ... Lessor may exercise any other right or remedy available to it by law or by agreement and may, in any event, recover legal fees and other expenses incurred

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[33] *Info. Leasing Corp. v. GDR Inv., Inc.*, 787 N.E. 2d at 655.

[34] *Canon Fin. Serv., Inc. v. Medico Stationary Serv., Inc.*, 751 N.Y.S.2d at 194; *Gen. Elec. Capital Corp. v. Nat'l Tractor Trailer School*, Inc., 667 N.Y.S.2d at 614.

> by reason of an Event of Default or exercise of any remedy hereunder, ...

Because Debtor accepted goods with respect to three of the four Leases and defaulted in its payment obligation, it has liability to Brown for rent and other obligations as stated above.

B. THE AMOUNT OF C.H. BROWN CO.'S UNSECURED CLAIM.

The Court will now address the Debtor's objection to the amount stated in Brown's proof of claim. Brown contends it is the holder of an unsecured claim for Debtor's prepetition breach of the four Leases calculated in accord with the forgoing remedies paragraph in the amount of $108,370 in Lease payments, plus prepetition and postpetition interest at the rate of 10%, reasonable attorney fees, and $2,000 per unit residual value (as established by the Leases), if the leased property is not returned to Brown. Debtor does not challenge the calculation of the Lease payments or the obligation to pay interest and attorney fees, but does contend that Brown has abandoned the leased equipment.

When there is an objection to a claim, the Code in section 502 directs the Court to determine the amount of an unsecured creditor's claim as of the date of filing the petition, excluding unmatured interest.[35] When making this calculation, the Court rejects Brown's claim in part.

First, as found above, the Debtor has liability on only three of the four Leases. Identification of the particular Lease on which Debtor is not liable is not possible because none of the sprinklers delivered have the serial numbers stated in the Leases or otherwise conform to the sprinklers described in the Leases. In the absence of any evidence to the contrary, the Court

[35] 11 U.S.C.A. § 502(b)(2).

holds that the deliveries accepted were with respect to the first three Leases, Lease numbers R135, R136, and R137. Under Code section 502, Brown is entitled to a claim for rental payments, prepetition interest at the contract rate, and prepetition attorneys fees and expenses with respect to these Leases. The claims for postpetiton interest and fees is disallowed pursuant to section 502.

The claim for the residual value of three of the sprinklers, in the total amount of $6,000 for the three units is approved. The residual value at the end of the Lease terms is established by the parties' agreements in the Leases. The remedies section of the Leases, paragraph 19, provides that upon default the lessor may recover as damages "compensation for loss of Lessor's anticipated residual value." That remedy is codified by Article 2A as follows:

> **Lessor's Right to Residual Interest.** In addition to any other recovery permitted by this article or other law, the lessor may recover form the lessee an amount that will fully compensate the lessor for any loss of or damage to the lessor's residual interest in the goods caused by the default of the lessee.[36]

The UCC does not make recovery of the loss of residual interest contingent upon the lessor's exercise of its right to recover the goods from the lessee. The Leases provide that the lessor may recover its loss, which includes the loss of its residual interest, without having to recover and dispose of the goods. Brown's failure to seek return of the sprinklers does not defeat it remedy of recovery of the residual value when the Debtor retains possession.

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[36] U.C.C. 2A-532. U.C.C. 2A-103(1)(q) defines the "lessor's residual interest" to mean "the lessor's interest in the goods after expiration, termination, or cancellation of the lease contract." Default by the lessee gives rise to the lessor's right to cancel the lease contract. U.C.C. 2A-523 (1)(a).

Within 30 days of this order, Brown shall file an amended proof of claim calculated in accord with this opinion. The Debtor shall have 10 days thereafter to file its objection, if any.

C. ASSUMPTION AND REJECTION.

Brown seeks an order of the Court setting a date by which the Debtor must assume or reject the Leases. By definition section 365 is applicable only to executory contracts and unexpired leases. "If the contract or lease has expired by its own terms or has been terminated under applicable law before the commencement of the bankruptcy case, there is nothing left for the trustee to assume or assign."[37] The traditional test for determining the existence of a contract within section 365 is to ask whether performance is due by both parties to the extent that nonperformance by either party would constitute a material breach excusing performance by the other. This is the Countryman test.[38]

Under this analysis, the Leases are not subject to assumption or rejection. They were terminated prepetition and were not executory on the date of filing. Under Article 2A, a lease is cancelled when "either party puts an end to the lease contract for default of the other party."[39] "On cancellation of the lease contract, all obligations that are still executory on both sides are discharged, but any right based upon prior default or performance survives, ..."[40]

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[37] 3 *Collier on Bankruptcy* ¶ 365.02[2](Alan N. Resnick & Henry J. Sommer eds-in-chief, 15th ed. rev. 2005); *see also* 2 *Norton Bankruptcy Law and Practice* §39:5 (Norton, auth & ed-in-chief 2005).

[38] 2 *Norton Bankruptcy Law and Practice* §39:6 (Norton, auth & ed-in-chief 2005).

[39] U.C.C. 2A-103(b).

[40] U.C.C. 2A-505(1).

As to the three Leases for which goods were delivered and not rejected, Debtor breached by failing to insure the goods and make lease payments. Brown filed suit in state court to recover the Lease payments, thereby electing to treat the Leases as cancelled. Article 2A provides that upon default by the lessee, the lessor may cancel the lease.[41] With respect to the fourth lease, no goods were tendered, and Debtor gave Brown notice of cancellation in his letter of November 1, 2001. Article 2A provides that if the lessor fails to deliver, the lessor is in default and the lessee may cancel the lease contract.[42] All of the Leases were cancelled prepetition and were not executory on the date of filing.

Further, Debtor has informed the Court that even if the Leases were subject to assumption or rejection, the Debtor would reject. But rejection would have no material impact upon the estate or Brown. If the Leases were terminated prepetition and are not executory, Brown has an unsecured claim for damages. If Debtor were to reject the Leases, Brown would be an unsecured creditor.[43]

The Court therefore denies Brown's motion to require the Debtor to assume or reject the Leases.

III. **Conclusion.**

For the foregoing reasons, the Court sustains the Debtor's objection to Brown's proof of claim in part and directs Brown to file an amended proof of claim consistent with this opinion within 30 days of the date of entry of this opinion. Debtor shall have 10 days thereafter to file its

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[41] U.C.C. 2A-523(1)(a).

[42] U.C.C. 2A-508(1).

[43] 11 U.S.C.A. § 365(g); 3 *Collier on Bankruptcy* ¶ 365.09[1](Alan N. Resnick & Henry J. Sommer eds-in-chief, 15th ed. rev. 2005).

objections, if any. The Court denies Brown's motion to determine a time for Debtor to assume or reject the Leases.

The foregoing constitutes Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A judgment based upon this ruling will be entered on a separate documents as required by Federal Rule of Bankruptcy Procedure 9021 and Federal Rule of Civil Procedure 58.

IT IS SO ORDERED.

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