MARKS & WEINBERG, P.C.

Jaz, Inc. v. B. Foley et. al.

2004 WL 194081 (Hawaii Ct. of App.)

This case provides a nice example of why Lessors should be careful to have Acceptance Certificates signed after the equipment is delivered. The Lessee acquired some photo processing equipment from Environmental First (ñVendorò) pursuant to an equipment lease with Hawaiian Leasing, Inc. (ñLessorò). Prior to delivery of the equipment, Lessee executed all relevant lease documents, including an Acceptance Certificate that was signed but not dated. Within the next couple of days, Lessor issued a Purchase Order to Vendor and wired the money. At that point, Lessor dated the Certificate of Acceptance. Lo and behold, the equipment was never delivered. Lessee made some lease payments to Lessor before bringing suit against both Lessor and Vendor. Default judgments were entered against Vendor and the majority of the opinion related to the respective rights of Lessee and Lessor.

The court made no analysis as to whether the ñLeaseò was a true lease governed by Article 2A of the Uniform Commercial Code or a lease intended as security but used Article 2A in the analysis. It noted that Article 2A provides default rules for what constitutes acceptance and when a Lessee owes payment under the statutory Hell and High Water Provisions in Article 2A but also noted that the parties are generally free to agree to any terms they wish by contract. As such, the court looked first to the terms of the Lease.

Of course, Lessor referred to: (1) the Acceptance Certificate which states that ñall of the equipment has been delivered and installed and the Lessee has accepted the equipment for purposes of

commencing Lesseeôs payment rental obligations under the Leaseò; (2) applicable provisions in the Master Lease which stated that "upon completion of its inspection of the equipment, the Lessee shall promptly deliver to the Lessor an executed Acceptance Certificate . . . or reject the equipment . . . "; and (33) the applicable provisions in the Master Lease which required Lessee to make payments under the lease notwithstanding any malfunction, loss or damage to the equipment."

The court analyzed whether or not a signed Acceptance Certificate is sufficient to show acceptance of the goods before delivery, quoting opinions from: (A) Texas-- *Stuart v. United States Leasing Corp.*, 702 S.W. 2d 288 (Tex. App. 1985) (Signed Acceptance Certificate was adequate); (B) Utah-- *Colonial Pacific Leasing Corp. v. J.W.C.J.R.,* 977 P. 2d 541 (Utah Ct. App.1999) (Accepted Certificate not sufficient); (C) Tennessee-- *Moses v. Newman,* 658 S. W. 2d 119 (10 Ct. App. 1983) (Acceptance Certificate not sufficient); and (D) Ohio-- *Information Leasing Corp. v. GDR Investments, Inc.*, 152 App. 3d 260 (2003) (Acceptance Certificate not sufficient). The general reasoning for the cases which invalidated the Acceptance Certificate was that ñ[t]he Lessee must have a reasonable time for inspection, which requires that Lessee have actual possession of the goods."

Using this case law and the general wording of the Acceptance Certificate and the Master Lease, the court held that the express agreement of the parties as described in the lease documents did not provide that for an Acceptance Certificate executed prior to delivery to be sufficient to result in acceptance of the equipment. The court noted that the language of the Acceptance Certificate provided that it was *only effective* to commence rental payments and obligations but was not intended to be an actual acceptance of the equipment. On the other hand, the Master Lease provided for the Acceptance Certificate to show actual acceptance but required, by its terms, that Lessee first inspect the equipment which inspection, according to the court, requires possession. The default rules under Article 2A similarly required possession since Section 2A-515 provides that ñacceptance of good occurs after Lessee had a reasonable opportunity to inspect the goods.ò

Having lost on its argument that the equipment had been accepted, Lessor also argued, without success, that Lessee impliedly accepted the equipment. Lessor's first argument was that, since it was required to pay for the equipment prior to delivery, Lessee impliedly accepted the equipment in advance of delivery. Unfortunately for Lessor, the Purchase Order provided that all the equipment would be subject to inspection by the Purchaser (i.e. Lessor) or Lessee and the court therefore held that Lessor gave Lessee the right of inspection even though prepayment was required.

Lessor next argued that the "hell and high water" and "event of loss" sections of the Master Lease shifted all risk of loss to Lessee. However, the court interpreted those clauses as shifting the risk of loss to Lessee only after the risk passed from Vendor. According to Section 2A-219 of the UCC, the risk of loss did not pass from the Vendor until the equipment is delivered. As such, there was no implied acceptance.

The key lesson is that the courts may not honor acceptance certificates executed prior to delivery of the equipment. As an additional note, lessors should use other methods to protect themselves to the extent they are willing to prefund with respect to vendors who require prepayments. For example, lessors can use progress payment agreements or, at the very least, the lessee should explicitly accept all risks relating to the vendor refusal or inability to deliver the goods or otherwise perform its obligations.

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