

UNITED STATES BANKRUPTCY COURT

DISTRICT OF SOUTH DAKOTA

ROOM 211

FEDERAL BUILDING AND U.S. POST OFFICE

225 SOUTH PIERRE STREET

PIERRE, SOUTH DAKOTA 57501

IRVIN N HOYT
CHIEF BANKRUPTCY JUDGE

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January 28, 1997

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Subject: *In re Ronald J. and Kim A. Tesch,*
Chapter 12; Bankr. No. 96-10115

Dear Counsel:

The matter before the Court is the MOTION TO APPROVE STIPULATION TO REJECT UNEXPIRED LEASE OF JOHN DEERE TRACTOR MODEL 4250 filed by M&I First National Leasing Corporation and Citizens State Bank of Arlington's objection thereto. Of the two primary issues presented by the parties' briefs, the first, whether Debtors' agreement with M&I First National Leasing Corporation is executory, is a core proceeding under 28 U.S.C. § 157(b)(2). The other issue, whether M&I First National Leasing Corporation or Citizens State Bank of Arlington has the superior security interest in the subject tractor is not addressed at this time as it is not a core proceeding nor the subject of an appropriate adversary proceeding. This letter decision and subsequent order shall constitute this Court's findings and conclusions on the first issue only. As set forth below, the Court concludes that the agreement between Debtors and M&I First National Leasing Corporation is not executory and cannot be "rejected" under 11 U.S.C. § 365(d).

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STIPULATED FACTS. On May 1, 1995, Citizens State Bank of Arlington (Bank) gave Ronald and Kim Tesch a line of credit for \$36,000.00 and received a promissory note, number 257, in return. The loan was to be repaid in installments with the final payment due February 5, 2000. According to the Bank's records, this loan refinanced an earlier debt and provided funds for the purchase of a new tractor. Note 257 was secured by a blanket security agreement dated March 29, 1995 that the Teschs had given the Bank earlier in conjunction with note number 228. The Bank had filed this earlier financing statement with the South Dakota Secretary of State on April 4, 1995. On May 2, 1995, the Bank advanced the Teschs \$16,000.00 to pay, according to the Bank's records, a cow lease. The \$16,000.00 was deposited in the Teschs' farm account number 400 313 3.

The Bank's March 29, 1995 security agreement with the Teschs stated that the Teschs pledged that it secured

All Debt(s). Except in those cases listed in the "LIMITATIONS" paragraph on page 2, each and every debt, liability and obligation of every type and description (whether such debt, liability or obligation now exists or is incurred or created in the future and whether it is or may be direct or indirect, due or to become due, absolute or contingent, primary or secondary, liquidated or unliquidated, or joint, several or joint and several).

The security agreement essentially blanketed all of the Teschs' property. In particular, it covered

Equipment: All equipment including, but not limited to, all machinery, vehicles, furniture, fixtures, manufacturing equipment, farm machinery and equipment, shop equipment, office and recordkeeping equipment, and parts and tools. All equipment described in a list or schedule which I give you will also be included in the secured property, but such a list is not necessary for a valid security interest in my equipment.

The security agreement also addressed purchase money security interests. It stated,

OWNERSHIP AND DUTIES TOWARD PROPERTY - I represent that I own all of the property, or to the extent this is a purchase money security interest I will acquire ownership of the property with the proceeds of the loan. I will defend it against any other claim. Your claim to the property is ahead of the claims of any other creditor.

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I agree to do whatever you require to protect your security interest and to keep your claim in the property ahead of the claims of other creditors. I will not do anything to harm your position.

PURCHASE MONEY SECURITY INTEREST - For the sole purpose of determining the extent of a purchase money security interest arising under this security agreement: (a) payments on any non-purchase money loan also secured by this agreement will not be deemed to apply to the purchase money loan, and (b) payments on the purchase money loan will be deemed to apply first to the non-purchase money portion of the loan, if any, and then to the purchase money obligations in the order in which the items of collateral were acquired or if acquired at the same time, in the order selected by you. No security interest will be terminated by application of this formula. "Purchase money loan" means any loan the proceeds of which, in whole or in part, are used to acquire any collateral securing the loan and all extensions, renewals, consolidations and refinancings of such loan.

On May 4, 1995, M&I First National Leasing Corporation (Leasing Corporation) purchased from Codington Clark Equipment Company (Equipment Company) a 1983 John Deere tractor, model 4250, for \$39,950.00. On May 5, 1995, Ronald Tesch executed a LEASE OF PERSONAL PROPERTY with the Leasing Corporation for the tractor and the tractor was delivered to him. The Leasing Corporation never had physical possession of the tractor before the Equipment Company delivered it to Ronald Tesch. On May 11, 1995, Ronald Tesch gave the Leasing Corporation a check for \$12,821.94. The check notation indicated it was for a "tractor operating lease."

On May 15, 1995, the Bank advanced the Teschs \$20,000.00 from their line of credit under note 257. The Bank placed the funds into the Teschs' farm account that day. The Bank records reflect that the \$20,000.00 advance was for the purchase of a new tractor.

Following the May 15, 1995 deposit of \$20,000.00, the Teschs' farm account had draws totaling \$2,469.39 on May 15 and 16, 1995. The Teschs' check for the \$12,821.94 tractor lease payment on May 11, 1995 did not clear on or before May 16, 1995.

The Leasing Corporation accepted the tractor lease on May 17, 1995. Attached to the accepted LEASE were an ADDENDUM A1, an AMENDMENT TO A LEASE OR LEASE SCHEDULE OF PERSONAL PROPERTY, and a MEMORANDUM REGARDING LEASE PROCESSING FEE. No bill of sale was issued to Ronald Tesch for

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the tractor. The expected life of the tractor, assuming regular maintenance and repair, is ten years.

The Leasing Corporation filed a financing statement with the South Dakota Secretary of State on May 19, 1995, that covered the tractor. Thereon, the Leasing Corporation stated, "We do not believe this transaction is subject to the Uniform Commercial Code but is filed in the event it is subject to the UCC and in such event secured party shall have a purchase money security interest."

As part of its regular business practice, the Leasing Corporation maintains a warehouse facility in Milwaukee, Wisconsin. The facility is used to store previously leased vehicles or equipment for which the lease had expired or where the lessee had defaulted.

From May 19, 1995 through January 22, 1996, the Teschs made regular payments on note 257. The Bank and Teschs renewed note 257 on January 22, 1996 at \$31,684.38, the balance due on that day. A new security agreement was not created. The renewal note number was 495. The Teschs made no payments on note 495 and defaulted.

The Teschs also defaulted on their tractor lease with the Leasing Corporation. They made no payments other than the initial payment of \$12,821.94. On or about April 12, 1996, the Leasing Corporation filed a complaint against Ronald Tesch. Therein, the Leasing Corporation stated Ronald Tesch had leased a tractor from it, that Ronald Tesch had failed to make the rent payments, and that additional late fees and charges had accrued. The Leasing Corporation sought possession of the tractor and a deficiency judgment for

(a) accrued and unpaid rent as of the date that Plaintiff obtains possession of the goods; (b) the present value, as of the date that the lessor obtains possession of the goods, of the difference between the total rent for the remaining lease term and the market rent at the time that [the Leasing Corporation] obtains possession of the goods; and (c) any incidental damages sustained by [the Leasing Corporation].

Alternatively, if the measure of damages provided above is not adequate to put [the Leasing Corporation] in as good of position as performance would have, [the Leasing Corporation] is entitled to the present value of the profit, including reasonable overhead, that the Plaintiff would have made from full performance by [Ronald Tesch], together with incidental damages, due allowance for costs

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reasonably incurred and due credit for payments or proceeds of disposition.

Bank was not a party to the suit. Ronald Tesch did not answer the complaint. The Leasing Corporation obtained a default judgment on May 22, 1996.¹ Under the judgment, the Leasing Corporation obtained possession of the tractor and it was awarded \$33,946.35, plus interest of \$521.18, and costs of \$35.00 for a total award of \$34,502.53. The judgment further stated that the Leasing Corporation

shall dispose of the subject tractor in a commercially reasonable manner, and apply the net proceeds to the amount of this judgment, as required and allowed by law. [the Leasing Corporation] shall file a report of sale, and have a deficiency judgment against [Ronald Tesch] for any amount remaining after application of said net proceeds.

The Teschs (Debtors) filed a Chapter 12 petition on May 29, 1996. On the date of filing, they still had possession of the tractor.

On September 13, 1996, the Leasing Corporation filed a motion to approve a stipulation between the Leasing Corporation and Debtors. The stipulation provided that Debtors would reject the "unexpired lease" of the tractor and that the unpaid balance on the lease as of May 22, 1996 was \$34,502.53. The Bank objected to the motion and the stipulation. The Bank contended that the lease between the Leasing Corporation and Debtors was really a security agreement, that the Bank had priority over the Leasing Corporation's security interest, and that Debtors could only abandon the tractor to the Bank. Both parties filed briefs and supplemental briefs.

Discussion. Section 15-6-62(a) of the South Dakota Code provides, in relevant part:

Except as stated herein or as otherwise ordered by the court for good cause shown, or upon default judgment, no execution shall issue upon a judgment nor shall proceedings be taken for its enforcement until the expiration of thirty days after its entry.

¹ The Hon. Robert L. Timm, South Dakota Unified Judicial System, Third Judicial Circuit, presiding.

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Section 15-26A-19 further provides that the filing of an appeal does not operate to stay proceedings except as may be ordered under that section; security is usually required. When these statutes are considered, it is clear that the state court default judgment against Debtors held by the Leasing Corporation was final on the Debtors' petition date. The judgment was entered by default so it was excepted from the thirty-day stay pending appeal under § 15-6-62(a). Further, Debtors had not appealed the judgment nor obtained a stay of proceedings as governed by § 15-26A-19. Thus, under state law, the judgment was final and enforceable by the Leasing Corporation on the petition date. Debtors' agreement with the Leasing Corporation has been extinguished since neither party was obligated to perform under it. See *Cameron v. Pfaff Plumbing and Heating, Inc.*, 966 F.2d 414, 416 (8th Cir. 1992); *Heikkila v. Carver (In re Carver)*, 71 B.R. 20, 22-23 (D.S.D. 1986), *aff'd.*, 828 F.2d 463 (8th Cir. 1987). The judgment now constitutes what the Leasing Corporation may enforce against Debtors.

Neither the potentiality of an appeal, *In re Issa Corp.*, 142 B.R. 75, 77 (Bankr. S.D.N.Y. 1992), nor the filing of a bankruptcy petition alters the finality of the judgment and the termination of the agreement under state law. *In re Jones*, 118 B.R. 395, 397 (Bankr. D.S.C. 1989). Neither the agreement between Debtors and the Leasing Corporation nor the tractor came into the bankruptcy estate since Debtors' legal rights therein had been extinguished prepetition. 11 U.S.C. § 541(a). Absent a preference action under 11 U.S.C. § 547(b) or a subsequent state court appeal that returns the tractor to the bankruptcy estate under § 541(a)(3), the bankruptcy estate property consists only of Debtors' right to an appeal. Thus, Debtor may not at this time assume or reject the terminated agreement under § 365(d)(2). *In re Gateway Investors, Ltd.*, 113 B.R. 564, 570 (Bankr. D.N.D. 1990).

The Leasing Corporation is now a judgment creditor entitled to possession of the tractor from Debtors and entitled to payment of \$34,502.53 from Debtors less any sale proceeds from the tractor. The Leasing Corporation may seek relief from the stay to enforce the judgment or it may participate in Debtors' plan. The Bank's security interest, if any, in the tractor was not altered or diminished by the judgment. Only Debtors and the Leasing Corporation's agreement was transformed into a judgment.

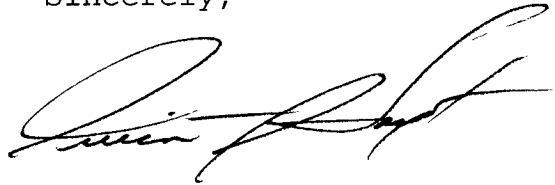
In concluding that the agreement is no longer executory, the Court does not conclude that the agreement between Debtors and the Leasing Corporation was a true lease. The Court is only holding the agreement, whatever its nature, has been supplanted by the judgment.

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This Court will not address whether the Leasing Corporation or the Bank has the superior interest in the subject tractor or its sale proceeds. Not only is the matter not properly before the Court as an adversary proceeding as required by F.R.Bankr.P. 7001(2) but the Court does not have jurisdiction under 28 U.S.C. § 157(b)(2) because the tractor is not estate property. Debtors' plan can recognize the contingent interests of the Bank and the Leasing Corporation in the tractor or its sale proceeds. In fact, Debtors already have so stipulated with the Bank. Further, the Code allows a confirmed plan to be modified to reflect distributions to a creditor outside of the plan. 11 U.S.C. § 1229(a)(3).

An order will be entered denying the Leasing Corporation's MOTION TO APPROVE STIPULATION TO REJECT UNEXPIRED LEASE OF JOHN DEERE TRACTOR MODEL 4250.

Sincerely,



Irvin N. Hoyt
Chief Bankruptcy Judge

INH:sh

CC: case file (docket original; copies to parties in interest)

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

JAN 28 1997

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

CERTIFICATE OF SERVICE
I hereby certify that a copy of this document was mailed, hand delivered, or filed this date to those creditors and other persons in the court identified on the attached checklist.
Clerk of Court
U.S. Bankruptcy Court
District of South Dakota
E-
Date: 1-28-97

Case: 96-10115 Form id: 122 Ntc Date: 01/28/97 Off: 3 Page : 1
Total notices mailed: 11

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