IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS, EASTERN DIVISION

IFC CREDIT CORPORATION, assignee of Norvergence, Inc.,	)	
Plaintiff,	)	Case No. 04 CV 5905
v.	)	Hon. Matthew Kennelly
UNITED BUSINESS & INDUSTRIAL FEDERAL CREDIT UNION,	)	
Defendant.	)	

IFC CREDIT CORPORATION'S RESPONSE TO DEFENDANT'S COMMENTS UPON CERTAIN ISSUES RAISED DURING THE FINAL PRETRIAL CONFERENCE

NOW COMES the Plaintiff, IFC CREDIT CORPORATION ("IFC"), assignee of Norvergence, Inc. ("Norvergence"), by and through its attorneys, Askounis & Borst, P.C., and for its Response to Defendant's Comments Upon Certain Issues Raised During the Final Pretrial Conference, states as follows:

INTRODUCTION

In July of 2003, Norvergence retained the law firm of Askounis & Borst, P.C. ("A&B") and Vincent Borst to represent it in a single collection matter against an unrelated lessee, Moo & Oink, Inc. ("Moo & Oink"), and a complaint was subsequently filed on July 28, 2003. See Affidavit of Vincent T. Borst, ¶ 3, attached here to as Exhibit A. On September 9, 2003, Moo & Oink filed a counterclaim alleging fraud by Norvergence. In October of 2003, IFC and Norvergence entered into the Master Program Agreement, a contract which governed the business relationship between the parties and set forth the manner in which IFC would take assignment of various equipment leases from Norvergence. A&B and Mr. Borst were not involved in any of the negotiations of the Master Program Agreement, nor were they involved in any of the business dealings between Norvergence

and IFC. See Affidavit ¶ 4. IFC also did not retain either Mr. Borst or A&B to represent it in IFC's purchase of any of the Norvergence leases, including the leases entered into by United Business & Industrial Federal Credit Union ("UBI"). See Affidavit ¶ 5.

Subsequent to the Master Program Agreement's execution, IFC purchased UBI's leases, the contracts at issue in this case, on or about January 12, 2004. See Rental Assignment Agreements, attached hereto as Group Exhibit B. After Norvergence's Chapter 11 bankruptcy converted to a Chapter 7 in July of 2004, many of the lessees to the leases IFC purchased began defaulting. In August of 2004, IFC first approached Mr. Borst in connection with A&B representing IFC in collecting on its Norvergence portfolio. See Affidavit, ¶ 6. Mr. Borst accepted on behalf of A&B, and A&B began representing IFC in various collection matters beginning in late August of 2004. See Affidavit, ¶ 7. On October 19, 2004, A&B filed a Motion to Withdraw as Counsel for Norvergence in the Moo & Oink case, which was granted on November 4, 2004. See Affidavit, ¶ 8 and Order dated November 4, 2004, attached hereto as Exhibit C. Because Norvergence did not obtain counsel after A&B's withdrawal, the court dismissed Norvergence's complaint for want of prosecution on December 16, 2004. See Order dated December 16, 2004, attached hereto as Exhibit D.

UBI claims that because Mr. Borst was aware in September of 2003 of the fraud allegations against Norvergence in Moo & Oink's counterclaim, that knowledge is somehow imputed to IFC such that IFC was not a holder in due course when it purchased the UBI leases in January of 2004. UBI also argues that the judgments rendered in the Federal Trade Commission, Illinois Attorney General, and Magnetic Technologies cases (the "Judgments") should be admissible as prima facie evidence that the UBI leases were fraudulently induced. For the reasons set forth below, UBI's contentions are wholly without merit.

A. Agency Issues Raised in UBI's Motion to Disqualify Attorneys.

1. Standard of Review.

"Motions to disqualify opposing counsel on the grounds that the movant intends to call him as an adverse witness have been subjected to particularly strict judicial scrutiny." Webster v. Spraying Systems Co., 1985 WL 2223,*1 (N.D. Ill. 1985). A Motion to Disqualify is viewed with "extreme caution . . . because the motion can be used as a means of harassment." United States v. Ligas, 2006 WL 1302465, *7 (N.D. Ill. 2006). Moreover, "[a] party is entitled to a degree of deference in the prerogative to proceed with counsel of its choice." Id. As set forth in detail below, UBI has failed to meet its burden in showing that IFC's counsel should be disqualified.

2. The only alleged imputed knowledge involved in this case is the allegations of fraud against Norvergence by Moo & Oink, not any knowledge regarding the alleged fraudulent scheme itself.

In order for the knowledge of an agent to bind his principal, the knowledge must have been acquired while his agent was acting within the scope of his authority and in reference to a matter over which his authority extends. People v. Gullborg, 324 Ill. 538, 155 N.E. 324 (Ill. 1927); see also Installation Services, Inc. v. Electronics Research, Inc., 2005 WL 3180129, *3 (N.D. Ill. 2005); Thomas v. Fredrick J. Borgsmiller, Inc., 155 Ill. App. 3d 1057, 1060-1061, 508 N.E.2d 1235, 1237 (Ill. App. Ct. 1987). Moreover, knowledge is imputed from agent to principal, not from principal to agent. See generally id. A search by IFC's counsel could not locate a case in which knowledge was imputed from principal to agent; IFC therefore avers that knowledge or information cannot be imputed from principal to agent, but instead can only be imputed from agent to principal.

UBI's contention that Mr. Borst has "relevant knowledge regarding the claims and defenses in this case and should be compelled to testify" (UBI's Motion to Disqualify Attorneys for IFC Credit Corporation, ¶ 13) is wholly unsubstantiated. UBI cannot demonstrate a good faith basis for

its contention, instead coming to the illogical conclusion that Mr. Borst must have known about Norvergence's alleged fraud merely because he represented Norvergence before IFC and Norvergence entered into the Master Program Agreement. However, UBI's unsubstantiated presumption is nothing more than mere speculation as the fact that Mr. Borst and A&B acted as attorneys for Norvergence does not mean that they had any knowledge of Norvergence's alleged fraudulent scheme. In fact, because knowledge can only be imputed from agent to principal and not vice versa, the only "knowledge" Mr. Borst would have is based solely on the allegations of fraud by Moo & Oink, a lessee in default and a defendant in a pending collection lawsuit against Mr. Borst's client at the time. Thus, imputed knowledge of the ***allegations*** of fraud – a customary defense to a breach of contract claim – and not imputed knowledge of the alleged fraudulent scheme itself is the only issue UBI claims gives inference to its contention that IFC is not a holder in due course.

3. An agent's knowledge while acting in the scope of his agency for one principal cannot be imputed upon another principal.

As an initial matter, UBI's theory that Mr. Borst's knowledge of the allegations of fraud against Norvergence while representing Norvergence can be imputed to IFC is absurd when examined on a common sense basis. Under UBI's nonsensical theory, Mr. Borst, while acting as an agent **limited** to representing Norvergence in a single case, had the duty to communicate Moo & Oink's allegations of fraud to every single one of his other clients on the off chance that one of his other clients may later enter into a separate transaction with Norvergence. Clearly, the proposition that Mr. Borst had to warn his other litigation clients about the fraud allegations of a defaulting lessee is, at best, both ridiculous and illogical.

The Court ordered UBI to find legal authority to support its contention that an agent's knowledge gained while acting as an agent of one principal can be imputed to an entirely different principal. UBI failed to cite to a single case for this proposition of law, instead referring to cases in

which the knowledge of an agent was imputed upon his principal or the knowledge of an attorney was imputed upon his client. See UBI's Comments Upon Certain Issues Raised, p. 5-7. Notably, none of UBI's cited cases involve a situation in which an agent's knowledge while acting on behalf of one principal was imputed to another principal.

Illinois law expressly holds that in such a situation, an agent's knowledge while acting in the scope of his agency for one principal cannot be attributed to an entirely different principal for which the agent may later act. The Illinois Supreme Court has dealt with the precise situation before this Court in the past and has held that "a party cannot be charged with notice of facts within the knowledge of his attorney, of which the latter acquired knowledge while acting as the attorney of another person." Herrington v. McCollum, 73 Ill. 476, *4 (Ill. 1874); see also McCormick v. Wheeler, Mellick & Co., 36 Ill. 114 (Ill. 1864) (a client cannot be charged with notice of facts on the grounds that they were known by his attorney if the knowledge of the attorney was acquire while he was acting as an attorney of another person); Roderick v. McMeekin, 204 Ill. 625, 68 N.E. 473 (Ill. 1903) (mortgagee could not be charged with notice that mortgagor did not have title to property by knowledge of mortgagee's agent because agent acquired knowledge while acting as the agent for another person).

In Neuberg v. Clute, the Illinois Supreme Court reiterated the same principle when faced with a case in which plaintiff Neuburg entered into a contract to purchase certain real property from owner Clute, and Clute sold the property to the Raabs in violation of the agreement between Neuburg and Clute. Neuburg v. Clute, 6 Ill.2d 58, 126 N.E.2d 648 (Ill. 1955). Frank Moland, an attorney who represented Clute in the transaction between Neuburg and Clute, also bid on behalf of the Raabs in a master's sale of the property, and the Raabs subsequently purchased the property. Id. at 60. When Nueburg learned of the sale, he sued for specific performance under his contract with Clute. Id. at 59. Claiming that Moland acted as an agent for the Raabs at the master's sale and that Moland had

knowledge of Nueburg's contract with Clute, Nueburg argued that Moland's notice of Nueburg's claim to the property could be imputed to the Raabs. Id. at 650. The Illinois Supreme Court found that Moland was not an agent or attorney for the Raabs, and even if he was, his knowledge of Nueburg's contract could still not be attributable to them:

> Even if Moland was the agent of the Raabs in the purchase of the property, however, they would still not be chargeable with notice through his knowledge of plaintiff's contract. Such knowledge was acquired by him while acting as attorney for Chute. He could not be expected to divulge information which would involve a breach of professional confidence. The rule charging a principal with the knowledge of his agent is subject to the qualification that the agent is at liberty to communicate his knowledge to his principal and that it is his duty to do so. It does not apply where at the time of receiving the notice the attorney was acting for another client whose interests were antagonistic. Under the circumstances shown in the case at bar, the Raabs cannot be chargeable with the knowledge possessed by Moland.

Id. at 650-651. Similarly here, any alleged knowledge acquired by Mr. Borst while acting as Norvergence's agent cannot be imputed to IFC.

Skiff-Murray v. Murray, 793 N.Y.S.2d 243 (N.Y. Sup. Ct. 2005), a case raised by the Court, states that an agent's imputable knowledge may include information learned in prior transactions or relationships. Id. at 246. Murray cites to the Restatement (Second) of Agency for the proposition that, "Except for knowledge acquired confidentially, the time, place, or manner in which knowledge is acquired by a servant or other agent is immaterial in determining the liability of his principal because of it." Id.; Restatement (Second) of Agency § 276 (West 2006). However, comment to the Restatement itself demonstrates that in the instant case, Mr. Borst's alleged knowledge cannot be imputed to IFC. Comment b to the Restatement asserts:

> Except where information is acquired confidentially, the time and method of its acquisition by an agent is important only in determining the inferences to be drawn as to the existence of knowledge when knowledge becomes important. Knowledge acquired casually or at

> a considerable period before the agent acts in the transaction is likely to be forgotten, and if the agent acquires the information before he becomes an agent or while he is not acting in his principal's affairs, and has forgotten it, the principal is not liable because of it, since the agent has no duty to the principal to remember.
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> Illustration:
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> 2. Before becoming cashier of the P bank, A overhears B tell C that B has obtained a note from D by fraud. Two days later the note comes before the discount committee of the P bank of which A is now a member and A, being absent-minded and having forgotten the conversation between B and C, accepts the note for the bank. The bank is not bound by A's past knowledge.

Restatement (Second) of Agency § 276, Comment b (West 2006).

Under the Restatement's analysis, Mr. Borst's knowledge of the fraud allegations in the Moo & Oink counterclaim cannot be imputed to IFC. Mr. Borst came across the fraud allegations against Norvergence in September of 2003 when representing Norvergence in a collection case in which IFC was not involved. IFC and Norvergence entered into the Master Program Agreement a month later in October of 2003. IFC did not retain either Mr. Borst or A&B to represent it in the negotiations of the Master Program Agreement, and they were similarly not involved in any of the business dealings between Norvergence and IFC. See Affidavit, ¶ 4. Mr. Borst and A&B also did not represent IFC in its purchase of any of the Norvergence leases, including the UBI leases purchased by IFC on January 12, 2004. See Affidavit, ¶ 5. In fact, Mr. Borst and A&B did not represent IFC in any Norvergence matter until August 2004, nearly eight months after the assignment of the UBI leases. See Affidavit, ¶ 6. Given the fact that Mr. Borst obtained knowledge of Norvergence's alleged fraud through the pleading of an adversary party, was not involved in the business dealings between IFC and Norvergence in any way, and did not represent IFC in any Norvergence cases until after the UBI leases were purchased, Mr. Borst's "knowledge" cannot be imputed to IFC.

Kelley v. United Benefit Life Insurance Co., 275 Ill.App. 112 (Ill. App. Ct. 1934), the other case raised by the Court, is distinguishable from the case at bar. The court in Kelley found that both

insurer principals, two separate but closely related companies, were properly furnished with proof of the insured's total permanent disability when the common agent for both was given notice of the proof. Id. The court's decision heavily relied on the fact that the companies not only shared the same agent but also had an overlapping interest in the same subject matter: the two companies had interlocking officers; occupied the same building; sold a combined plan of insurance; had the same general agent; and allowed the general agent to solicit insurance in both companies and receive and forward applications and all related materials in accordance to the policies. Id. at *1, *3. Accordingly, the court held that the general agent acted in a dual capacity and thus had the power to waive a second set of proofs by the insured for the other principal. Id. at *3. In contrast, IFC and Norvergence are separate and distinct corporations with no overlapping officers, directors, employees, or offices. Moreover, Mr. Borst did not have authority from one principal to act on behalf of the other principal. Because of this, it would be inequitable for the Court to hod that any knowledge obtained by Mr. Borst while acting as Norvergence's agent can later be imputed to IFC.

B. The Judgments should not be admitted as prima facie evidence that the UBI leases were fraudulently induced.

Though the Court has already rejected UBI's argument that the Judgments apply to IFC either under principles of *res judicata* or collateral estoppel, UBI argues that the Judgments should be admitted as prima facie evidence that the leases were fraudulently induced, citing to Greycas, Inc. v. Proud for the proposition that civil judgments can be admissible in subsequent proceedings. UBI's Comments Upon Certain Issues Raised, p. 8. However, the very case cited by UBI cuts against the admissibility of the Judgments in the instant case. The Seventh Circuit, in discussing why civil judgments are usually inadmissible hearsay, stated:

> A practical reason for denying [judgments] evidentiary effect is, however, the difficulty of weighing a judgment, considered as evidence, against whatever contrary evidence a party to the current suit might want to present. The difficulty must be especially great for

> a jury, which is apt to give exaggerated weight to a judgment. The analytical difficulties posed by efforts to use a judgment as evidence are, however, the only good reasons offered for the rule (others are canvassed in McCormick on Evidence, *supra*, § 318, at p. 894), and as they are of less or no force where, as in this case, the trial is not to a jury, we are not sure the rule should apply in such cases.

Id. at 1567. Thus, as the Seventh Circuit expressed, judgments should not be given evidentiary effect in jury trials because of the jury's likelihood of misinterpreting the significance of the previous judgment.

As the Court recognized at the final pretrial hearing, introduction of the Judgments in the instant case creates a problem under Federal Rule of Evidence 403, which provides, "Although relevant, evidence may be excluded if its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence." Fed. R. Evid. 403 (West 2006). The Advisory Committee notes provide, "Exclusion for risk of unfair prejudice, confusion of issues, misleading the jury, or waste of time, all find ample support in the authorities. 'Unfair prejudice' within its context means an undue tendency to suggest decision on an improper basis, commonly, though not necessarily, an emotional one." See id., Notes of Advisory Committee on Rules (West 2006). In contrast to the bench trial presented in Greycas, as the instant case is a jury trial, the Judgments should be excluded because of the jury's tendency to confuse the issues and give the Judgments exaggerated importance. Though UBI characterizes its desire to introduce the Judgments as prima facie evidence of fraud, the practical effect of the Judgments' admissibility is that the Judgments will have a preclusive effect on IFC without meeting the specific requirements of *res judicata* or collateral estoppel.

Moreover, given UBI's counsel's confusion over the relevance of fraudulent inducement as a defense, the likelihood of jury confusion is especially high in this case. Counsel for UBI has

repeatedly insisted that if UBI can prove fraudulent inducement, the contracts are void *ab initio*, regardless of whether IFC is a holder in due course. See UBI's Comments Upon Certain Issues Raised, p. 10. UBI's counsel is flat wrong in this contention. As the Uniform Commercial Code indicates, if IFC is a holder in due course, UBI can only assert certain limited "real defenses" against IFC. 810 ILCS 5/9-403(c)(West 2006). UBI's contention that the leases were fraudulently induced is not a "real defense" and is thus barred:

> 2. Subsection (a)(2) states other defenses that, pursuant to subsection (b), are cut off by a holder in due course. These defenses comprise those specifically stated in Article 3 and those based on common law contract principles. Article 3 defenses [include] . . . instruments issued without consideration or for which promised performance has not been given (Section 3-303(b))[.] . . . The most prevalent common law defenses are fraud[.] . . . Assume Buyer issues a note to Seller in payment of the price of goods that Seller fraudulently promises to deliver but which are never delivered. Seller negotiates the note to Holder who has no notice of the fraud. If Holder is a holder in due course, Holder is not subject to Buyer's defense of fraud.

810 ILCS 5/3-305, Comment 2 (West 2006). As the comment clearly indicates, if IFC is a holder in due course, then UBI's fraudulent inducement defense cannot be raised. Given the fact that even UBI's counsel has repeatedly misunderstood the law on this point, the jury will undoubtedly be similarly be confused. Accordingly, the Judgments must be excluded because of the danger of confusion of issues.

Similarly, admitting the Judgments into evidence will unfairly prejudice IFC. Because a jury will probably exaggerate the importance of default judgments brought against Norvergence (a debtor in Chapter 7 bankruptcy) by government agencies, they will likely render a decision on an improper basis. Because of this, introduction of the Judgments will have little evidentiary value and instead will merely inflame the jury and cause unfair prejudice to IFC. Accordingly, because the Court has already ruled that the Judgments have no preclusive effect on IFC and will only lead to confusion of issues and unfair prejudice to IFC, they must be excluded.

IFC CREDIT CORPORATION,

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CERTIFICATE OF SERVICE

I hereby certify that on July 25, 2006, I electronically filed the foregoing **IFC Credit Corporation's Response to Defendant's Comments Upon Certain Issues Raised During The Final Pretrial Conference** with the Clerk of the Court using the CM/ECF system, which will send notification to Gregory Adamski at gaadamski@yahoo.com.

s/Debra R. Devassy

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