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UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW JERSEY

	]	Case No. 04-32079/RG
In re	]	Chapter 7
	]	
NorVERGENCE, INC.,	]	Hearing Date: November 9, 2004
	]	11:00 a.m.
Debtor.	]	
	]	Oral Argument Requested

OBJECTION OF FRAUD VICTIMS TO
IFC'S MOTION FOR RELIEF FROM THE AUTOMATIC STAY

TO THE HONORABLE ROSEMARY GAMBARDELLA, BANKRUPTCY JUDGE:

COME NOW the parties in interest[1] identified in Exhibit A hereto, each of whom has been

1 The parties identified are holders of claims against the Debtor, among others, arising from, among other things, fraud, fraudulent inducement, misrepresentation, negligent misrepresentation, conversion, breach of contract, unjust

victimized by, among other things, the fraudulent conduct of the Debtor ("Debtor") and its officers, directors, agents and employees, among others (collectively, "Fraud Victims"), by and through their undersigned counsel, and as their objection ("Objection") to the Motion of IFC Credit Corporation ("IFC") seeking relief from the automatic stay ("Stay Motion"), dated July 23, 2004, respectfully represent as follows:

BACKGROUND

1. The Fraud Victims are purportedly the lessees under various equipment leases entered into with the Debtor as a result of the false, fraudulent, deceptive and misleading representations, inducements, statements, offerings, promises and warranties, made by the Debtor itself and acting through its agents, representatives, employees, officers, directors and shareholders, concerning, among other things, the value, functionality, purpose, efficiency, and content of various pieces of physical equipment, as well as the purported recipients of services being and/or to be rendered by and on behalf of the Debtor, as part of and in tandem and concert with the leasing of this phony equipment, as a "bundled" package of purported valuable equipment and services.

2. It appears, although the Fraud Victims were largely unaware of these alleged facts until very recently, that the Debtor would systematically sell or assign or somehow transfer to third party financing entities all or some of the contractual agreements entered into between the Fraud Victims and the Debtor.

3. It appears that IFC is one of the financing entities to whom the Debtor would make these assignments.

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enrichment, and deceptive trade practices.

4. It also appears, so far as is known to the Fraud Victims, that, in some instances, the assignment or transfer of the Debtor's interest in various contracts with its victims would be absolute and unconditional (subject to some purported right of IFC to "put" the assigned contractual rights back to the Debtor), and, in some other instances, such as those surrounding the Stay Motion, the Debtor merely pledged the contract rights as collateral to IFC.

5. It appears that the contracts with each of the Fraud Victims, in contrast to other victims of the Debtor's fraudulent activities, were not assigned absolutely, but were merely pledged as collateral to IFC for some alleged consideration.[2]

6. Because the contract rights of the Fraud Victims have only been pledged as collateral and not assigned absolutely or unconditionally, it appears that the Debtor, or, more properly, the Debtor's estate, retains presently, and as of the filing of the instant case, a property interest in each of the contracts with the Fraud Victims, thereby constituting property of the bankruptcy estate under §541 of the Bankruptcy Code ("Code"), 11 U.S.C. §101-1330.

7. It now appears that IFC seeks relief from the automatic stay, through the extant Stay Motion, in order to foreclose or otherwise act against and with respect to the contracts with the Fraud Victims pledged to it by the Debtor on the eve of its bankruptcy filing.

8. However, the Stay Motion asserts a lien on the same contract rights as to which at least one other entity, Access Integrated Technologies, Inc. ("Access"), thus far asserts a lien of greater priority than

2 It appears in the Stay Motion that IFC asserts that the pledge of the contracts of the Fraud Victims was done in exchange for IFC's alleged forbearance from taking action to enforce it right to receive payment for contract rights as to which it exercised its "put" option; this alleged "consideration" supporting the grant of a security interest to IFC on the eve of the Debtor's bankruptcy is discussed hereinbelow.

IFC. See, *"Objection of Access Integrated Technologies, Inc., to Application of IFC Credit Corporation for Entry of an Order Granting IFC Credit Corporation Relief from the Automatic Stay Pursuant to 11 U.S.C. §362(d)*" ("Access Objection"); this dispute as to the priority of competing liens has not yet been resolved, so far as is known to the Fraud Victims as of the date of this Objection.

ARGUMENT

9. The Fraud Victims object to the granting of the relief sought by IFC in the Stay Motion for the following reasons, among others:

A. *IFC May Be Unsecured and Entitled to Neither Relief from the Automatic Stay nor Adequate Protection*.

10. Under §506 of the Bankruptcy Code, a creditor holding a security interest is deemed to be a secured creditor only to the extent that value exists in its collateral[3], and exists as well over and above the amount of the claims secured by any superior liens. *United States v. Ron Pair Enterprises, Inc*., 489 U.S. 235, 239, 109 S. Ct. 1026, 1029, 103 L. Ed. 2d 290 (1989) (Section 506(a) "provides that a claim is secured only to the extent of the value of the property on which the lien is fixed.)"; see also *Johns v Rousseau Mortgage Corp. (In re Johns)* 37 F.3d 1021, 26 BCD 228, (3rd Cir. 1994).

11. In the instant case, Access, through its Access Objection, asserts a lien securing a claim in excess of $4,800,000.00 which allegedly encumbers, among other things, the contract rights of the Fraud Victims. The lien claimed by Access is also purportedly superior in time and therefore in right to the alleged

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3 "An allowed claim of a creditor secured by a lien on property in which the estate has an interest … is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property" 11 U.S.C. §506(a) (West 2004).

lien of IFC.

12. Because of this, IFC must establish, before it is entitled to the relief sought in the Stay Motion that (a) IFC's security interest is superior to the lien of Access, and that the collateral – *i.e.*, the contracts with the Fraud Victims – has value[4]; or (b) there is sufficient value to fully secure Access and IFC regardless of whose lien is superior in right to the contracts of the Fraud Victims. For reasons explained more fully below, IFC must fail in this regard for two reasons: first, the lien of IFC is inferior to that of Access[5], and the contracts securing the claims of both Access and IFC are worthless and of no value whatsoever. See, e.g., *In re Emarco, Inc*., 45 B.R. 627 (Bankr. M.D. Pa. 1985) (worthlessness of collateral renders seemingly secured claim unsecured under §506(a)). Accordingly, the claim of IFC is deemed unsecured under §506 of the Bankruptcy Code, and IFC is entitled to neither relief from the stay nor adequate protection, and the Stay Motion must be denied.[6] B. *The Lien Asserted by IFC is Preferential and Voidable, and Cannot Form the Basis for Relief from the Automatic Stay*.

13. In its Stay Motion, IFC admits that the *only* consideration given by IFC for its receipt of a lien (perfected, according to the Stay Motion, on June 25, 2004, only 5 days before the involuntary petition was filed against the Debtor) on the Fraud Victims' contracts was "forbearance." In defense of the

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4 IFC admits in the Stay Motion that it has no idea what its alleged collateral is worth, but that it may indeed be worthless. ¶10.

5 The Fraud Victims hereby reserve all rights, claims, causes of action, defenses, offsets, recoupments, counterclaims, crossclaims and all other rights and powers which they or any of them may have with respect to Access and its alleged lien on the Fraud Victims' contracts.

6 At a minimum, the Stay Motion must be deferred until a determination is made as to the order of priority among competing liens, and the extent of IFC's secured status, which are among this Court's primary responsibilities under 28 U.S.C. §157(d),

unavoidability and non-preferential status of the security interest, IFC insists that forbearance can serve as sufficient consideration to constitute value or "new value" thereby vouchsafing its lien. However, this argument is wrong. *In re Duffy*, 3 B.R. 263, 266 (Bankr. S.D.N.Y. 1980) (forbearance insufficient to constitute value under § 547(a)(2) and provides no valid defense to preference challenge); accord, *In re Mid Atlantic Fund, Inc.*, 60 B.R. 604 (Bankr. S.D.N.Y. 1986).[7] Further, *In re Jet Florida*, 841 F.2d 1082 (11th Cir. 1988), cited by IFC, the Court of Appeals concluded that forbearance from evicting the debtor was not value sufficient to defend an otherwise preferential transfer because the debtor did not occupy the premises, thereby rendering the forbearance a nullity. In the instant case, IFC assets that its forbearance left the Debtor with better cash flow than it would have had if IFC had enforced fully its right to repayment for contracts it "put" back to the Debtor. Ignored here is the *Air Florida* scenario: the Debtor was bankrupt less than two weeks after IFC's "valuable" forbearance, and the Debtor derived *no* benefit from IFC's act of forbearance. Further still, IFC's alleged forbearance was not from foreclosing or repossessing collateral, or evicting the Debtor from premises, where retention of collateral or possession of premises from which a debtor could continue operations is to some greater or lesser extent demonstrably valuable to a debtor. Instead, this forbearance was merely from initiating legal action to collect the amount for which the Debtor was obligated to repay IFC as a result of IFC's exercise of its "put" back to the

7 See also *American Bank of Martin County v. Leasing Service Corp. (In re Air Conditioning, Inc. of Stuart)*, 845 F.2d 293, 298 (11th Cir. 1988), cert. denied, 488 U.S. 993 (1988); *In re Jet Florida System, Inc.*, 841 F.2d 1082; *Drabkin v. A.I. Credit Corp*., 800 F.2d 1153, 1158-59 (D.C. Cir. 1986); *In re Thomas McKinnon Securities Inc.*, 125 B.R. 94, 97-98 (Bankr. S.D. N.Y. 1991); *In re Nucorp Energy, Inc.*, 80 B.R. 517 (Bankr. S.D. Cal. 1987); *Matter of Installation Services, Inc.*, 101 B.R. 282, 285 (Bankr. N.D. Ala. 1989); *Van Huffel Tube Corp. v. A & G Indus. (Matter of Van Huffel Tube Corp.)*, 74 B.R. 579, 587 (Bankr. N.D. Ohio 1987); *Bavely v. Merchants Nat'l Bank (Matter of Lario)*, 36 B.R. 582, 584 (Bankr. S.D. Ohio 983); *Matter of Duffy*, 3 B.R. 263, 265-66 (Bankr. S.D. N.Y. 1980) (cited by *Aero-Fastener, Inc. v. Sierracin Corp. (In re Aero-Fastener, Inc.)*, 177 B.R. 120 138-9 (Bankr. D. Mass. 1994) (rejecting forbearance as consideration to defeat preference claim).

Debtor. Merely forbearing from taking action to interfere with the Debtor's cash flow, such as suing to recover the money owed by IFC, or, as in T*rans World Airlines v Travellers Int'l AG. (In re Trans World Airlines)* 180 BR 389 (Bankr. D. Del. 1994), aff'd in part and rev'd in part, remanded on other grounds, 203 BR 890. (D. Del. 1996), from levying on the debtor's cash flow, does not put back and replenish the assets of the debtor sufficient to constitute value in defense of a preference claim.

14. Because the transfer of a security interest on, among other things, the contracts of the Fraud Victims constitutes a preference, and because IFC's one articulated defense is without merit, IFC's security interest, as to which it seeks protection though its Stay Motion, is voidable as a preference and deserving of no protection. On this basis, as well, the Stay Motion must be denied.

C. *It Would be Inequitable, Prejudicial and Unfair to the Fraud Victims to Permit IFC to Foreclose on its Alleged Collateral and thereby Assert Successors' Rights.*

15. Although the Fraud Victims do not so concede, the apparent or intended consequence to the Fraud Victims of granting relief from the automatic stay to permit IFC to perfect its title to the contracts between the Debtor and the Fraud Victims, is to permit IFC to assert some type of "holder in due course" status vis-à-vis the Fraud Victims. IFC essentially admits that this is such a consequence in its "Further Application" filed with this Court on or about August 9, 2004, at ¶4. The impact upon the Fraud Victims is profound and obvious: if permitted to perfect is title, IFC will assert that it is, or it is in the nature of, a "holder in due course," and, necessarily, cut off the defenses of the Fraud Victims to the validity of the contracts themselves and to their purported obligation to pay under their contracts.

16. The Fraud Victims have substantial defenses to their obligation to pay, as described hereinbelow. The Bankruptcy Court, as a court of equity, should consider the impact on the Fraud Victims of permitting their defenses to be eviscerated by the maneuverings of IFC, who, the Fraud Victims assert, is not as innocent and unknowing a conditional assignee as it avers repeatedly.

17. In sum, between 2001 and up until its involuntary bankruptcy on June 30, 2004, the Debtor promised the Fraud Victims that it would deliver inexpensive, unlimited local and long-distance phone, cell phone service, and high-speed internet access to them, as well as more than 11,000 small and medium-sized businesses in twenty (20) states across the country. The Debtor represented that it could provide unlimited local, long distance, cellular and internet services to small business owners with good credit ratings at discount prices that were below the current (and more limited) monthly communications services that were currently being provided to the prospective customers by other communications companies. The Debtor represented that these discounted rates and services were available only through the use of a proprietary and expensive "Matrix" box that would supposedly allow them to obtain unlimited local and long distance calling with no per minute charge, high speed internet service and unlimited cellular phone service. However, to obtain this unlimited deeply discounted and technologically superior service, the Debtor required its customers to sign five-year contracts "hardware and service rental" plans that included the installation and use of its "Matrix" box. The Debtor procured telephone/telecommunications bills from the Fraud Victims, totaled their current telephone/telecommunications costs, and guaranteed them that their "Matrix" solution "unlimited" service would be at least 10% less than their current bills from other vendors.

18. Once the Debtor determined the total new reduced fixed monthly cost for a Fraud Victim's telephone/telecommunications services package, they "backed out" certain minimal fixed monthly service costs (which they arbitrarily determined and which had no relationship to their true value), such as for "circuit facility" (*e.g.*, $9.99 per month) and cellular and internet access. The remaining balance (which could exceed 90% of the total monthly bill and which varied with each customer) was then allocated to "rental" of the "Matrix" box.

19. However, the "Matrix" and "Matrix SOHO" are respectively, an 850 RCU and 2050 RCU or similar piece of equipment made by a public company called Adtran, and these same boxes are available for sale in the public market for costs ranging from approximately $200 to $2,000. Neither piece of equipment does anything to make landline phone calls unlimited for local, long distance or toll free 800 dialing, or make cellular calls unlimited for flat rate charges. The "Matrix" is a standard T1 integrated access device (IAD), which supports voice data and video streaming over a single high capacity circuit. IAD can combine multiple services so that one line can replace multiple access lines, and provide an internet access device and an intra-office router. The Matrix SOHO does nothing to save phone or intranet costs, and does not even allow phone line connection for access to the internet. In fact, for a customer, such as the Fraud Victims herein, the "Matrix" box is and was useless. Nonetheless, the Debtor marketed services to small businesses, such as the Fraud Victims, who did not have a telecommunications department or telecommunications specialist amongst their staff.

20. These "Matrix" boxes were further useless to small businesses such as the Fraud Victims as the unlimited phone and net services had nothing to do with the "Matrix" box. In some instances, the Debtor never even physically connected the "Matrix" box to their customers' telephone lines or equipment.

21. The Debtor required the Fraud Victims to sign five (5) year rental equipment leases for the "Matrix" box as part of their contract for communications services. However, the Debtor and its agents separated this monthly lease bill for the "Matrix" box apart from each customer's bill for monthly telephone and internet services although the "Matrix" box and communications services were marketed and represented as one complete service plan.

22. The Debtor then purported to sell and/or assign the "Matrix" equipment leases to banks, leasing companies, and other financial institutions – such as IFC -- separate from the telecommunications services they represented that the Fraud Victims were obtaining from the Debtor. In many cases, the "Matrix" box was never delivered or installed at the Fraud Victims' premises and, even if installed, the phone service promised was never connected or provided by the Debtor. In all cases, the "Matrix" box did not provide any function for the Fraud Victims' telecommunications services and thereby severely injured their businesses.

23. Clearly, the Debtor made material misrepresentations of fact to the Fraud Victims in order to induce the Fraud Victims to enter into a commercial agreement with the Debtor, *i.e.*, -- the Debtor and its agents represented falsely to the Fraud Victims that the rental of the "Matrix" was necessary to obtain the deeply discounted rates on the long-distance, cellular service, and internet service that the Debtor sold to the Fraud Victims. The Debtor further represented falsely to the Fraud Victims that it could provide

telephone and telecommunications services at a deeply discounted rate through the "Matrix" box. The Debtor further represented to the Fraud Victims that the "Matrix" box contained valuable, unique and proprietary property, and, therefore, the box was extremely valuable and justified the high rental payments being charged by the Debtor.

24. In fact, the "Matrix" box was not necessary at all for the Fraud Victim's long-distance, cellular service, and internet services that they reasonably believed they were obtaining from the Debtor. Further, the Fraud Victims were not provided with the discounted long-distance, cellular service, and internet services that the Debtor and its agents represented they were unable to be provided by the Debtor. Further, the lease rentals being charged bore no relationship to the true value of the "Matrix" boxes; in fact, the boxes cost only a small fraction of the fraudulent, inflated rentals charged and were worthless to the Fraud Victims. When the Debtor made these material misrepresentations, it knew they were false, or, at least, made such misrepresentations recklessly without any knowledge of their truth. The Debtor made these material misrepresentations with the intention that the Fraud Victims act upon and rely upon said misrepresentations. Indeed, the Debtor and its agents made these material misrepresentations so that the Fraud Victims would sign a lease for a virtually useless apparatus under a lease that could subsequently be sold, assigned or pledged by the Debtor to a bank, finance or leasing company for the mutual benefit and profit of the Debtor and its agents and the banks, finance and leasing companies. The banks, finance and leasing companies paid the Debtor a facially dubious and questionable highly-discounted price for the Debtor leases for the right to collect exorbitant and unconscionable payments from the Fraud Victims each month for the "rental" of useless equipment. In fact, as the Debtor knew, should have known, and

intended, that the Fraud Victims would rely on the material misrepresentations made by the Debtor and its agents and sign "equipment rental agreements" for the worthless "Matrix" boxes from the Debtor.

25. As noted, in the course of the Debtor's business, the Debtor represented to the Fraud Victims that the Fraud Victims were required to purchase the "black box" or "Matrix" to obtain the deeply discounted rates on the long-distance, cellular service, and internet services that the Debtor sold to the Fraud Victims. The Debtor further represented to the Fraud Victims that the "Matrix" boxes were could provide telephone and telecommunications services through the Debtor at highly discounted rates. The representations made by the Debtor were made with the intent that they be relied upon by the Fraud Victims.

26. Because the Debtor procured the rental equipment agreements by the above-described fraudulent inducements and material misrepresentations regarding the value, use and need for the "Matrix" *inter alia*, all said rental equipment agreements must be declared void and unenforceable. Because the "Matrix" boxes have no function and, therefore, the Fraud Victims received no value out of the lease agreements, these rental equipment agreements are void and unenforceable.

27. In addition, the contracts are void and unenforceable as against IFC because IFC knew or should have known that the Debtor was perpetuating a fraudulent scam on its customers, the Fraud Victims.

WHEREFORE, the Fraud Victims request this Honorable Court enter an order:

1. Denying relief under the Stay Motion; and

2. Granting such other and further relief as is just and proper.

Dated: October 15, 2004

Respectfully submitted,

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By /s/
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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was served by overnight delivery, prepaid, on October 15, 2004, on the following:

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