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

FEDERAL TRADE COMMISSION,	)	
	)	Case No. 07 C 3155
Plaintiff,	)	
	)	Judge Joan B. Gottschall
v.	)	
	)	Magistrate Judge Cole
IFC CREDIT CORPORATION,	)	
	)	
Defendant.	)	
	)	

IFC CREDIT CORPORATION'S REPLY BRIEF IN SUPPORT OF ITS MOTION TO DISMISS PLAINTIFF FEDERAL TRADE COMMISSION'S COMPLAINT FOR INJUNCTIVE AND EQUITABLE RELIEF

NOW COMES Defendant IFC Credit Corporation ("IFC"), by and through its attorneys, and for its Reply Brief in Support of Its Motion to Dismiss Plaintiff Federal Trade Commission's Complaint for Injunctive and Equitable Relief, states as follows:

INTRODUCTION

IFC's Motion to Dismiss demonstrates that: (1) the FTC's Complaint exceeds the scope of the FTC's authority under the FTC Act since this lawsuit does not seek to protect "consumers" but instead seeks to unwind corporate contracts; (2) the FTC fails to state a claim upon which relief can be granted; and (3) the FTC's proposed application of the FTC Act to enjoin IFC's court-related collection activities infringes upon IFC's First Amendment and Fifth Amendment constitutional rights. IFC's Motion is guided primarily by four black letter law principles, which apply to the FTC just as they apply to any other litigant: (1) to the extent the exhibits to a complaint contradict the allegations therein, the exhibits control; (2) when the Court is confronted with an unambiguous contract, it must construe the terms as written under the plain meaning rule; (3) a contract

which results from fraudulent misrepresentation is voidable, not void; and (4) laws such as the FTC Act are narrowly construed.

In its Response Brief, the FTC violates each of these four principles, asking the Court to disregard the unambiguous terms of short, plain equipment leases entered into by and between business entities. In contrast to the instant case, the FTC fulfills its consumer protection mandate when it ensures that the consumer marketplace is not distorted by unfair or deceptive acts or practices. Here, the FTC oversteps its bounds when it seeks to interfere after the fact with valid, business-to-business contracts, purportedly because small businesses took on risks that later became uneconomical. Accordingly, the FTC's case should be dismissed in its entirety.

ARGUMENT

1. Standard of Review.

The FTC would have this Court believe that any allegation contained in its Complaint, regardless of whether it is conclusory, contradicted by the exhibits thereto, or contrary to binding case law, should be blindly accepted at face value. This statement is erroneous. *42nd Parallel North v. E Street Denim Co.*, 286 F.3d 401, 406 (7th Cir. 2002) ("In considering a motion to dismiss, the court is not required to don blinders and ignore commercial reality.") Though the Court may accept as true all well-pled allegations of the Complaint, the Court is not "compelled to accept conclusory allegations concerning the legal effect of facts set out in the complaint" or "unsupported conclusions of fact." *Reed v. City of Chicago*, 77 F.3d 1049, 1051 (7th Cir. 1996); *McLeod v. Arrow Marine Transport, Inc.*, 258 F.3d 608, 614 (7th Cir. 2001). Additionally, when the exhibits

contradict the allegations of the complaint, the exhibits trump the allegations. *Thompson v. Illinois Department of Professional Regulation*, 300 F.3d 750, 754 (7th Cir. 2002).

2. The FTC's Complaint exceeds the scope of its authority under the FTC Act because the allegedly injured parties are not "consumers" but rather merchants utilizing the goods at issue for business purposes only.

A. The FTC's own statutes and regulations repeatedly limit the definition of the term "consumers" to persons acquiring goods for "personal, family or household use" only.

By its terms, the FTC Act limits the FTC's authority under 15 U.S.C. § 45(a)(2) to regulate only those practices which it considers unfair and harmful to "consumers." *See* 15 U.S.C. § 45(n) (West 2007) ("The Commission shall have no authority...unless the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.") This litigation does not involve any alleged injury to "consumers." Rather, the FTC is attempting to undo contracts, which were privately entered into by and between business entities. Each of these contracts involved goods that were, without dispute, *not* to be used for personal, family, or household purposes at all. *See* Equipment Rental Agreements ("ERAs"), Group Exhibit 1 to IFC's Motion to Dismiss.[1]

The FTC "adamantly disputes" that the term "consumer" is intended to include only persons acquiring goods for "personal, family, or household use." *See* FTC's

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[1] As discussed in IFC's Motion to Dismiss, though the FTC repeatedly referenced the various documents the Lessees signed and the text contained therein and attached them to its Motion for Preliminary Injunction, the FTC failed to attach the documents as exhibits to its Complaint. For the Court's convenience, IFC attached the referenced documents in its Motion to Dismiss. Because the FTC has made these documents part of the public record by attaching them to its Motion for Preliminary Injunction, the Court may take judicial notice of the documents without converting IFC's Motion to Dismiss into a Motion for Summary Judgment. *See Doherty v. City of Chicago*, 75 F.3d 318, 325, n. 4 (7th Cir. 1996); *Davis v. Bayless*, 70 F.3d 367, 372, n. 3 (5th Cir. 1995).

Response to IFC's Motion to Dismiss ("FTC's Response Brief"), p. 5. However, the FTC cites no black letter law supporting its contention that the term "consumer," as used in the FTC Act, 15 U.S.C. § 45(n) (West 2007), is intended to include merchants who are acquiring goods solely for business use. Instead, the FTC argues that this Court should simply defer to the FTC's present interpretation of the term "consumer," which is inconsistent with prior codified definitions of this term.

The United States Supreme Court has held that, where it appears that a federal agency such as the FTC has overstepped its bounds in construing a statutory provision in a manner that Congress would not have intended, courts must reject those administrative constructions. *See Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-844 (1984). In determining whether an agency's construction of a statute is permissible, "[f]irst, always, is the question whether Congress has directly spoken to the precise question at issue." *Chevron*, 467 U.S. at 842. "If the intent of Congress is clear, that is the end of the matter." *Id.* "The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional authority." *Id.* at 843, n.9. "If a court, employing traditional tools of statutory construction, ascertains that Congress had an intention on the precise question at issue, that intention is law and must be given effect." *Id.*

A review of the authorities cited by both IFC and FTC makes clear that, each time the FTC has defined the term "consumer," the FTC's own regulations have consistently limited the word "consumer" to include only those persons who acquire goods for "personal, family, or household use." *See* 16 C.F.R. § 433.1(b) (2007) (defining "consumer" as a "natural person who seeks or acquires goods or services for personal

family or household use"); 16 C.F.R. § 429.0(b) (2007) (defining "consumer goods or services" as "[g]oods or services purchased, leased, or rented primarily for personal, family or household purposes"); 16 C.F.R. § 444.1(d) (2007) (defining the term "consumer" as a "natural person who seeks or acquires goods, services or money for personal, family or household use").[2] This conclusion is also in accord with Congress' definition of the term "consumer" as used in the Magnuson-Moss Warranty – Federal Trade Commission Improvement Act, 15 U.S.C.S. § 2301(1)-(3) (defining "consumer product" as "any tangible personal property which is distributed in commerce and which is normally used for personal, family or household purposes").[3] Hence, the term "consumer" plainly refers to persons acquiring goods for "personal, family or household use," and the FTC cannot now attempt to go beyond that which Congress intended.

These consistent definitions of the term "consumer" clearly express an intention on the precise question at issue, and "must be given effect" by the Court. *See Chevron, supra.* The FTC cites to no authority holding that a court must defer to an agency's attempt to avoid expressly articulated definitions contained within its own rules. Hence, the Court should defer only to the definitions contained within the FTC's own rules, 16 C.F.R. § 433.1(b) (2007); 16 C.F.R. § 429.0(b) (2007); 16 C.F.R. § 444.1(d) (2007), and not the FTC's impermissible latter-day attempts to avoid its own definitions.

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[2] FTC rules are subject to formal congressional review. *See* H.R. Rep. No. 156, Pt. 1, 98th Cong., 1st Sess., 44 (1983).

[3] Contrary to the FTC's argument, Title II does nothing to alter the definition of "consumer" in Section 5(n) to include businesses. *See* FTC Response Brief at pp. 7-8. As the FTC concedes, the quoted text comes from comments regarding an original version of a bill – one that did not pass. *Id.*, p. 8, n.5. The legislative history reveals that the amendment was designed to expand the FTC's jurisdiction to include activities "in or affecting commerce." *See* Report, Conference Comm. on S.356, H.R. Rep. 93-1107 (1974). According to the House of Representatives, the purpose behind enacting the bill was to protect the sizeable concentrations of "poor and poorly educated" in large cities that the FTC could not previously protect. *Id.*

Furthermore, under statutory construction principles, "identical words" used in different parts of the same act or statutory scheme "are intended to have the same meaning." *See Dept. of Revenue of Oregon v. ACF Industries, Inc.*, 510 U.S. 332, 342 (1994); *National Organization of Veterans' Advocates, Inc. v. Secretary of Veterans Affairs,* 260 F.3d 1365, 1379 (Fed. Cir. 2001). The FTC and Congress have repeatedly used the identical term "consumer" in different parts of the same statutory scheme intended to protect "consumers" from unfairness or deception. Time and again, the FTC and Congress ascribed the same meaning to that term – one that limits the term "consumer" to a purchaser of goods for "personal, family and household use." Consequently, the ordinary rules of statutory construction do not support the FTC's current attempt to circumvent its own rules. Instead, these rules of statutory construction demand that the term "consumer," as used in the FTC Act, be ascribed the same meaning as when the FTC and Congress has used that term in 16 C.F.R. § 433.1(b) (2007); 16 C.F.R. § 429.0(b) (2007); 16 C.F.R. § 444.1(d) (2007); and 15 U.S.C.S. § 2301(1)-(3).

Rather than rely on its own definitions, the FTC attempts to create ambiguity by suggesting that the inclusion of the word "businessmen" in *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233, 244 (1972), supports the FTC's current interpretation of the term "consumer." However, the *Sperry* opinion clearly refers to the term "consumer" as an ***alternative*** to the term "competition or other businessmen." Contrary to the FTC's claim, *Sperry* does not define the term "consumer" to include "businessmen." Nor does *Sperry* bolster the FTC's argument that the Unfairness Policy Statement discussion includes "businessmen." To interpret the Policy Statements' use of the term "consumer" to also include "businessmen" would also necessarily mean that the Policy Statement includes

"competitors" as well. However, the FTC clearly is not arguing that "competitors" are "consumers" under Section 45(n) of the FTC Act.

The FTC's Unfairness Policy Statement is a review of cases and analysis of the "most important principles" regarding consumer unfairness applicability, as well as a clarification of the FTC's beliefs regarding its unfairness jurisdiction as stated in *Sperry*. *See* Unfairness Policy Statement. Yet, the Unfairness Policy Statement refers specifically to the injuries of consumers, and not injuries to competitors or businessmen. *Id.* Surely, the FTC's commissioners reviewed the *Sperry* decision and were aware of the Supreme Court's reference to "businessmen" prior to drafting the Unfairness Policy Statement. Nonetheless, the FTC did not include "businessmen" when it clarified the FTC's policy on unfairness, suggesting commercial businesses are not included in the term "consumers." This inference is bolstered by the FTC's own regulations, which exclude businesses from the FTC's definition of the term "consumer." *See* 16 C.F.R. § 433.1(b) (2007); 16 C.F.R. § 429.0(b) (2007); 16 C.F.R. § 444.1(d) (2007); and 15 U.S.C.S. § 2301(1)-(3).

Finally, the FTC appears to suggest that the use of the word "consumer" in Section 5(n) of the FTC Act only serves to limit the FTC's jurisdiction over "unfair" acts and not "deceptive" acts under Section 45(a)(2). The FTC offers no basis for making such an argument. Moreover, assuming *arguendo*, then the Court must, at the very least, dismiss Counts II and III of the FTC's Complaint, which solely relate to "unfair" acts.

B. The FTC cites no binding precedent permitting a broader definition of the term "consumer."

Critically, the FTC is unable to pinpoint a single instance in which the FTC defined the term "consumer" within its regulations to include business entities purchasing

goods for strictly commercial use. The FTC instead points to three unrelated trade regulations, none of which uses the term "consumer" at all, let alone a broader definition of the term "consumer" in the manner suggested by the FTC. *See* 16 C.F.R. § 436 (Franchise Rule); 16 C.F.R. § 435 (Mail or Telephone Order Merchandise Rule); 16 C.F.R. § 310 (Telemarketing Sales Rule). These regulations have no application here. Contrary to the regulations and statutes cited by IFC *supra,* which repeatedly use the term "consumer" and consistently define that term to include limited transactions involving personal, family or household goods, the three regulations cited by the FTC are entirely distinguishable because they do not use the term "consumer."

The FTC also hypothesizes that applying its own definition of the term "consumer" to the FTC Act's consumer unfairness provision would somehow invalidate years of enforcement of the Franchise Rule. This statement is a red herring. The Franchise Rule is wholly unrelated to the FTC Act's consumer unfairness provision. The FTC fails to state how any of its cited regulations have any connection to this case. Indeed, the FTC concedes that the Franchise Rule "is entirely about businesses." *See* FTC's Response Brief, p. 12. The Franchise Rule is distinguishable from the FTC Act's consumer unfairness provision, which exists to protect "consumers." *See* 15 U.S.C. § 45(n) (West 2007). Moreover, the historical background of these regulations reveals that, prior to adoption, the subject of business-to-business transactions was vigorously examined and debated. *See, e.g.*, 72 Fed. Reg. 15444; 58 Fed. Reg. 49120. In contrast, the legislative history of the FTC Act's unfairness provisions does not contain any examination or debate as to whether strictly commercial business-to-business transactions should be included within its scope. *See* FTC "Unfairness Policy Statement" of 1980

(appended to *Int'l Harvester*, 104 F.T.C. at 1070); H.R. Rep. No. 156, Pt. 1, 98th Cong., 1st Sess. (1983); S. Rep. No. 130, 103rd Cong., 1st Sess. (1993); and H.R. Rep. No. 138, 103rd Cong., 1st Sess. (1993).

Similarly, the Court should not defer to the fact that the FTC has recently brought and settled various unfairness cases, under the guise of protecting businesses as "consumers." These FTC complaints and settlements do not have the force of law. Moreover, the mere fact that others have not previously challenged the FTC on this issue does not give the FTC the unfettered right to exceed the scope of the FTC Act.[4] The FTC is not free to "write its own law of consumer protection." *See Am. Financial Svcs Ass'n v. FTC*, 767 F.2d 957, 965 (D.C. Cir. 1985) (*quoting National Petroleum Refiners Ass'n v. FTC*, 482 F.2d 672, 693 (D.C. Cir. 1973), *cert. denied*, 415 U.S. 951 (1974)). The FTC is a creation of Congress and cannot go beyond the authority specifically granted to it. *Id.* at 965. If the FTC wishes to expand the definition of the word "consumer" to include small businesses, it must seek congressional approval, but it has failed to do so.

[4] *In the matter of Spiegel, Inc.*, 86 F.T.C. 425 (1975), a challenge to the application of the FTC Act to businesses may not have been raised because the goods at issue appear to have consisted of "clothing, household goods," and the like. Also, distinguished from the case at bar, the majority of the customers in *Spiegel* consisted of true consumers, whereas, in the instant matter, all of the Lessees are businesses acquiring goods for commercial use only. *See* ERAs, Group Exhibit 1 to IFC's Motion to Dismiss. Similarly, *Int'l Harvester Co.*, 104 F.T.C. 949 (1984) (wherein the FTC sought to protect individual farmers from personal injury) and *Orkin Exterminating Co., Inc.*, 108 F.T.C. 263 (1986) (wherein the FTC brought its action on behalf of individual homeowners) involved situations where the vast majority of the "consumers" sought to be protected were natural persons acquiring goods for personal, family or household use. None of these cases involved a situation like the one at bar, in which the FTC brought suit solely to protect commercial entities which contracted with another business to acquire goods strictly for commercial use. These unique circumstances are likely the reason why this challenge to the FTC's consumer unfairness authority has not been raised sooner.

C. Permitting the FTC to interpret the term "consumer" in a manner inconsistent with its own rules and the intent of Congress would frustrate the purpose of the FTC.

As stated by Congress, the FTC's mission is to "promote the efficient functioning of the marketplace." *See* H.R. Rep. 103-138. Nevertheless, the FTC has a documented history of occasionally using its consumer unfairness authority in an overly aggressive fashion to the detriment of the free market. *See Am. Financial*, 767 F.2d at 969-70 (describing how the FTC's "activism" resulted in "criticism of the vagueness and breadth of the unfairness doctrine"; Congress subsequently "solicited statement and held oversight hearings on the question of whether the FTC's unfairness authority should be eliminated or permanently restricted"). When faced with the possibility of having its consumer unfairness authority stripped altogether, the FTC represented to Congress in its 1980 Policy Statement that it would, from that point forward, take a less heavy-handed approach to its consumer unfairness jurisdiction. *See Am. Financial*, *supra*; Unfairness Policy Statement. Among other things, the FTC specifically represented that it would, in the future, rely upon "the ability of individual consumers to make their own private purchasing decisions without regulatory intervention – to govern the market." *See* Unfairness Policy Statement. In the instant case, the Lessees do not even meet the FTC's own definition of individual "consumers." As these Lessees are businesses, they could rely upon their own business judgment when making commercial purchasing decisions. Thus, the need for regulatory intervention in private purchasing decisions presented by these circumstances is further reduced.

The FTC's lawsuit against IFC runs contrary to this legislative background. If this Court were to permit the FTC to interpret the term "consumer" in a manner

inconsistent with the FTC's own congressionally-approved regulations, it would frustrate the FTC's stated mission, which is to "promote the efficient functioning of the marketplace." *See* H.R. Rep. 103-138. Changing the definition of the word "consumer" would subject sophisticated business-to-business transactions to the same level of regulatory interference by the federal government as those deals involving unsophisticated true consumers, which in turn would chill the commercial marketplace.

For example, in the case at bar, the FTC is already taking direct aim at a variety of standard commercial contract provisions (*i.e.*, the "hell or high water," waiver of defenses, waiver of warranties, and forum selection clauses), essentially deeming them illegal. These clauses are routinely relied upon by businesses. Indeed, they are expressly embraced by the Uniform Commercial Code (*see, e.g.*, U.C.C. §§ 2-316; 2A-407; 2A-212 and 213; 9-403), and uniformly enforced by courts in commercial settings because they are viewed as essential to the U.S. economy. *See, e.g.*, *In re O.P.M.*, 21 B.R. 993, 1007-08 (Bankr. S.D.N.Y. 1982) ("hell or high water" clauses deemed "essential" to industry; to deny their effect would "seriously chill business"). Extending the FTC's consumer unfairness jurisdiction to encompass sophisticated business-to-business transactions like the ones at bar will have a destructive impact on the U.S. marketplace. Virtually every lease agreement executed in the United States contains one or more of these types of clauses, which, under the FTC's purported new definition of "consumer," would allow the FTC to invalidate any or all of these contracts at its sole discretion. This unbridled power would have the potential to bring U.S. commerce to a screeching halt.[5]

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[5] By way of further example, the Franchise Rule touted by the FTC has resulted in harsh criticism from the very franchisees the FTC purports to protect in that Rule. *See* 72 Fed. Reg. 15444 at n.40 (stating that the American Franchisee Association's "members feel so strongly about the Commission's inability to deal

From the above analysis, the FTC clearly exceeded the scope of its authority under the FTC Act's consumer unfairness doctrine when it brought claims on behalf of commercial entities for contracts involving purely commercial goods. Accordingly, the FTC's Complaint must be dismissed as a matter of law.

3. The Complaint must be dismissed because IFC's rights are enforceable under Article 2A of the UCC.

The FTC's entire case hinges on a legal conclusion that the ERAs are service agreements and not (as they state on their face) leases for the Matrix box equipment. For if the ERAs are equipment leases – as they so state – then UCC Article 2A governs the leases and IFC's pre-suit and in-court statements to the Lessees all are certainly colorable (and, in IFC's view, absolutely truthful) representations regarding its legal position,[6] not actionable as a violation of the FTC Act. *See* IFC's Motion to Dismiss, pp. 16-20. Responding, the FTC asserts a legal conclusion that the ERAs should be recharacterized as service agreements. That will not do. Even on a motion to dismiss, the Court can (and should) disregard legal conclusions. *Reed*, 77 F.3d at 1051. Here, the putative conclusions that the ERAs are disguised service agreements depends entirely on allegations that are contrary to the plain and unambiguous terms of the ERAs themselves, which refer only to the Matrix boxes, and, as the FTC acknowledges, "omit[] any mention of the [telecommunications] services" allegedly financed. *See* FTC's Response Brief, p. 3; *see FTC v. Verity International, Ltd.*, 335 F.Supp.2d 479, 498 (S.D.N.Y. 2004) (applying plain language of two page equipment lease; dismissing claimed

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with substantive issues of concern to them, they would rather work to abolish the FTC rule than suffer the abuses of both a government agency *and* their franchisors") (emphasis in original).

[6] *See, e.g.,* FTC's Response Brief at p. 15 n. 16 ("In private litigation, finance companies (including IFC) have won some and lost some.")

violation of FTC Act). Because the unambiguous terms of the contracts prevail over the FTC's attempt to recharacterize their terms, the FTC's case fails. Recognizing this fatal deficiency, the FTC also claims that it can attack conduct under the FTC Act, even if that same conduct is permissible under state law. *See* FTC's Response Brief, p. 15. That argument is not only irrelevant, but also clearly incorrect as to the matters at issue here.

A. Because the plain language of the contracts prevails, the FTC cannot rewrite equipment leases into services agreements after the fact.

The FTC's attempt to plead around the plain language of the ERAs cannot succeed. As demonstrated in IFC's Motion to Dismiss, the ERAs are straightforward, two-page contracts that, on their face, apply only to renting equipment (the Matrix boxes). The FTC acknowledges, as it must, that the ERAs "omit[] any mention" of future telecommunications services. *See* FTC's Response Brief, p. 3.[7] In these circumstances, the law is clear – the FTC cannot prevail on pleadings that vary from the plain language of the contracts. *Thompson*, 300 F.3d at 754 (when the exhibits to a complaint contradict the allegations, the exhibits control); *Verity International,* 335 F.Supp.2d at 498 (dismissing count for FTC Act violation for failing to disclose the cost of using Internet services where costs were plainly identified on a two-page disclosure form that was displayed to users before they accessed the services).

The FTC weakly contends that, notwithstanding the plain language of the ERAs, the original parties (NorVergence and the Lessees) intended and understood that the ERAs were services agreements. *See* FTC's Response Brief, p. 16. That, however, contradicts the plain language of the ERAs. *See* ERAs, Group Exhibit 1 to IFC's Motion

[7] Indeed, the Lessees executed separate Services and Hardware Applications, reinforcing that there were two separate agreements, one for equipment and a different one for services. *See* Group Exhibit 3 to IFC's Motion to Dismiss and Exhibit 29, pp. 57-58 to the FTC's Motion for Preliminary Injunction.

to Dismiss. The FTC's argument also ignores the fact that NorVergence and the Lessees each executed a separate application and agreement for services. *See* Group Exhibit 3 to IFC's Motion to Dismiss and Exhibit 29, pp. 57-58 to the FTC's Motion for Preliminary Injunction. The Lessees also received two separate documents that enumerated NorVergence's promises regarding the equipment and services, again indicating that they were two separate agreements – the Equipment Warranty for Matrix and the ATM Service Level Agreement. *See* Exhibit 29, pp. 47-48 to the FTC's Motion for Preliminary Injunction. Moreover, the signed, written representations in the Delivery & Acceptance Certificates ("D&As") expressly state that, "There are no side agreements or cancellation clauses given outside the Equipment Rental Agreement." *See* D&As, Group Exhibit 2 to IFC's Motion to Dismiss. Finally, the FTC's argument flies in the face of settled law that parol allegations or evidence of intent cannot supersede the plain language of subsequently executed, written contracts. *S&O Liquidating Partnership v. Commission of Internal Revenue*, 291 F.3d 454, 459 (7th Cir. 2002); *Fleet Business Credit, LLC v. Enterasys Networks, Inc.*, 352 Ill.App.3d 456, 470, 816 N.E.2d 619, 630 (Ill. App. Court. 2004). This is especially true where, as here, the ERAs include integration or merger clauses stating that the Lessees' obligations are not subject to terms not included in the ERAs. *See* ERAs, Group Exhibit 1 to IFC's Motion to Dismiss.

Lastly, the FTC's assertion that *Custom Data Solutions v. Preferred Capital* is the only appellate decision on the merits (FTC's Response Brief, p. 15 n. 16) is mistaken. In *Liberty Bank, F.S.B. v. Diamond Paint and Supply, Inc.*, 2006 WL 2691719 (Iowa App. Sept. 21, 2006), the Iowa Court of Appeals enforced the ERAs' "hell or high water"

clauses and granted summary judgment to leasing company. In disposing of the Lessees' argument that the ERAs are services agreements, the court stated:

> Defendants argue the rental agreements do not fall within the scope of the UCC because the agreements are predominantly for services, not goods. However, the rental agreement is titled "Equipment Rental Agreement" and makes repeated reference to "equipment." Schedule A sets forth a lengthy list of the equipment with which the agreements deal. There is no genuine dispute that the agreements cover goods and not services.

Liberty Bank, 2006 WL 2691719, *1. Moreover, even if *Preferred Capital* was the only decision on the merits (which it is not), it would not be persuasive or helpful precedent. Unlike IFC, Preferred Capital ***never*** raised the argument that UCC Article 2A or Article 9 applied or refuted the allegations regarding NorVergence's alleged fraudulent inducement. *See* Appellant Brief of Preferred Capital, attached hereto as Exhibit 1.[8]

B. Nothing in the FTC Act permits the FTC to ignore the plain language of the written contracts

Attempting to avoid the foregoing legal principles, the FTC argues that IFC's state law cases are inapposite because the FTC can attack conduct under the FTC Act even if that same conduct is permissible under state law. *See* FTC's Response Brief, p. 15. However, that argument is entirely irrelevant as nothing in the FTC Act purports to supersede federal pleading rules. Thus, whatever the outer boundaries of the FTC Act may be, the FTC still cannot survive a motion to dismiss by putting forth allegations that contravene the exhibits.

[8] Because Preferred Capital's Appellate Brief is part of the public record, the Court may take judicial notice of the brief without converting the Motion to Dismiss into a Motion for Summary Judgment. *See Doherty*, 75 F.3d at 325, n. 4; *Davis*, 70 F.3d at 372, n. 3.

As to the substantive law, the issue on the pending Motion to Dismiss simply is whether the usual and ordinary canons of contract construction apply. On that point, state and federal law are identical. *Compare S&O Liquidating Partnership v. Commission of Internal Revenue*, 291 F.3d 454, 459 (7th Cir. 2002) with *Fleet Business Credit, LLC v. Enterasys Networks, Inc.*, 352 Ill.App.3d 456, 470, 816 N.E.2d 619, 630 (Ill. App. Court. 2004) and *W.W. Vincent and Co. v. First Colony Life Insurance Co.*, 351 Ill. App. 3d 752, 757, 814 N.E.2d 960, 966 (Ill. App. Ct. 2004).

While it is true that Section 5 of the FTC Act is not necessarily coextensive with state substantive law, nothing in the FTC Act exempts the FTC from the ordinary and usual principles of contract construction. *See Dr. Pepper/Seven-Up Companies, Inc. v. FTC*, 151 F.R.D. 483 (D.C. Cir. 1993); *Orkin Exterminating Co. v. FTC*, 849 F.2d 1354 (11th Cir. 1988); *Crittenden v. FTC*, 19 F.3d 26 (9th Cir. 1994). Thus, when the FTC seeks to enforce the FTC Act in a Section 5 action, the FTC is bound by the same canons and rules of statutory and contract construction that apply across the board in other common law and statutory contexts. Any contrary position would mean that the FTC essentially is a sovereign unto itself, making its own rules in an FTC vacuum. That has never been the law, nor is it the law today. Unsurprisingly, cases decided under Section 5 of the FTC Act refer to and apply ordinary canons of contract construction. *See e.g. Orkin*, 849 F.2d 1354; *Verity International*, 335 F.Supp.2d at 498.

Indeed, the FTC's argument is entirely theoretical. The FTC never provides a reason why the conduct at issue in this case – enforcement of specifically agreed-to contract provisions that have been examined and approved by a number of federal and state appellate courts – should nevertheless be deemed "deceptive" under Section 5. The

facts are that IFC seeks to enforce its rights under two-page agreements, entered into by and between business entities, with the pertinent language highlighted for emphasis and accessibility. The FTC provides no reason why it should be able to deem those provisions deceptive under Section 5, when those contract terms are acceptable under state law.

Finally, the FTC hinges its argument on the Seventh Circuit's decision in *FTC v. Spiegel*, 540 F.2d 287 (7th Cir. 1976). But *Spiegel* was an "unfairness" case, not a deception case. *Id.* In addition, the *Spiegel* case dealt with a party that was using Illinois' long arm statute to hale out-of-state defendants into state court. *Id.* It was at least arguable there that the out-of-state companies would not be on notice of Illinois' long arm statute, making it "unfair" to subject them to the reach of that statute. In contrast here, IFC seeks only to enforce specific, written contract provisions that the Lessees voluntarily entered into.

C. Article 2A provides a complete defense, as a matter of law.

UCC Section 2A-407 provides that once a lessee accepts the equipment under a finance lease, the lessee's promise that its payments are unconditional (*i.e.*, a statutorily implied "hell or high water" clause) is fully enforceable. 810 ILCS 5/2A-407 (West 2007). IFC's position while litigating these cases against the Lessees has been because the parties agreed that the ERAs will be treated like "finance leases" and because the Lessees "accepted" the equipment through their execution of the D&As, the "hell or high water" clauses are enforceable, obligating the Lessees to make payments to IFC.

The FTC claims that IFC had no basis to make this representation, contending that the ERAs were not "finance leases" because NorVergence allegedly selected and

supplied the equipment. Regardless of who selected the equipment, as a matter of law, parties to a contract can agree to treat a lease as a "finance lease" even though the transaction would not otherwise qualify as such. 810 ILCS 5/2A-103(1)(g), Comment g (West 2007); IFC's Motion to Dismiss, p. 18. In response, the FTC argues that the ERAs' terms do not unequivocally state that they are "finance leases" because the Article 2A Paragraph provides that "if" Article 2A applies to the ERAs, the ERAs will be considered finance leases. *See* FTC's Response Brief, pp. 16-17 and ERAs, Group Exhibit 1 to IFC's Motion to Dismiss.

The FTC's argument misses the point. The FTC does not elaborate on how this "if" materially affects the parties' agreement that the ERAs are "finance leases," nor does the FTC address IFC's argument that because the ERAs are clearly "leases" as defined by 810 ILCS 5/2A-103(j), Section 2A-407 applies. Article 2A will govern the ERAs if they are equipment leases; IFC's Motion to Dismiss demonstrates that the ERAs are precisely that, and the FTC cannot plead around the ERAs' plain language to avoid that conclusion. *See* IFC's Motion to Dismiss, p. 17. The unambiguous language of the ERAs plainly states that the parties were, in fact, executing and entering into equipment leases and not service agreements: "We agree to rent to you and you agree to rent from us the Equipment listed below (the 'Equipment')." *See* Group Exhibit 1 to IFC's Motion to Dismiss. The ERAs also state that the Lessees retained no right to own the equipment at the end of the leases' term and were required to return the equipment to NorVergence. *Id.* The FTC simply has no answer to this point in its Response Brief.

Article 2A thus governs the ERAs. The Iowa Court of Appeals in *Liberty Bank* agreed with IFC's position, despite the existence of the conditional language the FTC

relies upon here, holding that the ERAs' terms unequivocally stated that the ERAs would be treated as "finance leases":

> Defendants also argue the hell or high water clauses are not enforceable because the agreements are not finance leases. We disagree. The rental agreement states: ARTICLE 2A STATEMENT: YOU AGREE THAT IF ARTICLE 2A OF THE UNIFORM COMMERCIAL CODE IS DEEMED TO APPLY TO THIS RENTAL, THIS RENTAL WILL BE CONSIDERED A FINANCE LEASE THEREUNDER. YOU WAIVE YOUR RIGHTS AND REMEDIES UNDER ARTICLE 2A of the UCC.
>
> Article 2A applies to "any transaction, regardless of form, that creates a lease." Iowa Code § 554.13102. We conclude the rental agreement meets the definition of a lease as provided in Article 2A. *See* Iowa Code § 554.13103(1)(j) (defining a lease as "a transfer of the right to possession and use of goods for a term in return for consideration"). Accordingly, Article 2A applies to the rental and therefore the parties agreed it would be a finance lease. *Star Photo Lab, Inc.*, 672 N.W.2d at 505.

Liberty Bank, 2006 WL 2691719, *1-2. The court further found that the Lessees accepted the equipment through the execution of the D&As and thus enforced the "hell or high water" clauses. *Id.* Again, the FTC's claim that the ERAs are not "finance leases" is contradicted by the ERAs – *i.e.* the exhibits to the Complaint – which control, not the FTC's baseless conclusions. *Thompson*, 300 F.3d at 754.

The FTC contends that "no consumer when buying phone services could have understood that Article 2A would force them to pay even if they never received any services." *See* FTC's Response Brief, p. 17. This statement contradicts the FTC's own admission in its Complaint that the "hell or high water" clauses clearly create the "impression that the consumer's duty to pay would survive a complete failure of consideration." *See* Complaint, ¶ 45. Thus, as the FTC acknowledges, the plain meaning

of the "hell or high water" clauses (without any specialized understanding of Article 2A) makes the Lessees' payment obligations unconditional. Even assuming *arguendo* that the Lessees could not understand the implications of Article 2A, the FTC has no explanation as to why the Lessees were unable to read or understand the clear and unambiguous terms of the express "hell or high water" clauses, waiver of defenses provision, disclaimer of warranties clause, and the "**AS IS**" provision, terms whose meaning should have been obvious to any reader.

Moreover, the FTC's insinuation throughout its brief that some special rule of law applies to commercial entities – as all of the Lessees were commercial entities – which are not in the Fortune 500 or are not publicly traded is simply untrue. Commercial entities, regardless of their size, are presumed to know the contents of contracts they sign. *Heller Financial, Inc. v. Midwhey Powder Co., Inc.*, 883 F.2d 1286, 1292 (7th Cir. 1989); *Rubino v. Circuit City Stores, Inc.*, 324 Ill. App. 3d 931, 937, 758 N.E.2d 1, 5 (Ill. App. Ct. 2001). Thus, the Lessees cannot be held to any lesser standard merely because some of them may be smaller businesses.

The FTC amazingly goes so far as to suggest that because it has alleged that the Lessees were incapable of understanding the provisions of the two-page ERAs, the Court must accept this allegation as true such that IFC's Motion to Dismiss must be denied. To the contrary, the Court is only required to accept well-pled facts as true, not legal conclusions or unsupported conclusions of fact. *Reed*, 77 F.3d at 1051; *McLeod*, 258 F.3d at 614. Accordingly, as the ERAs state that they are "finance leases," the Lessees executed D&As representing that they accepted the equipment, and in light of the Iowa Court of Appeals' decision in *Liberty Bank*, IFC had a colorable basis for representing to

the Lessees that they had an unconditional obligation to make payments under the "hell or high water" clauses.

4. The FTC has failed to state a claim for "deceptive practices" under Count I.

When a contract dispute arises between two businesses, they can and should be able to discuss those disputes – including their respective legal positions – without fear that the FTC can sue them under Section 5 merely for putting forth a good-faith articulation of their respective legal positions. That is the law as demonstrated in IFC's Motion to Dismiss, and the FTC does not disagree with that point. Instead, the FTC attempts misdirection, arguing that it can be a deceptive practice to ***misrepresent*** a party's legal position. That, of course, puts the cart before the horse. There can be no "misrepresentation" where the assertion of a legal position is in good faith: *i.e.*, grounded upon a fair reading of the contract documents and supported by numerous court decisions, as is the case here. The FTC also again argues that conduct permissible under state law can be actionable under Section 5 of the FTC Act. But that argument is particularly misplaced here, where the underlying conduct consists of in and out-of-court discussions between private parties concerning their respective rights under state law or a party's articulation of its legal position. The outermost bounds of Section 5 have no bearing on the propriety of that conduct.

A. Articulating a party's legal position cannot be a deceptive practice.

It is not a deceptive practice to articulate a party's legal position. *Randazzo v. Harris Bank Palatine, N.A.*, 262 F.3d 663, 671 (7th Cir. 2001); *Harris Trust & Savings Bank v. Great-West Life Assurance Co.*, 1989 WL 117984, *5 (N.D. Ill. 1989; *Notaro Homes, Inc. v. Chicago Title Insurance Company*, 309 Ill.App.3d 246, 259, 722 N.E.2d

208, 218 (Ill. App. Ct. 1999), *reversed on other grounds in First Midwest Bank, N.A. v. Stewart Title Guaranty Co.*, 218 Ill.2d 326, 843 N.E.2d 327 (Ill. 2006); *Hoseman v. Weinschneider*, 322 F.3d 468, 477, n. 2 (7th Cir. 2003). Nor is it "deceptive" to enforce a contract as written. *Robinson v. Toyota Motor Credit Corp.*, 201 Ill.2d 403, 420, 775 N.E.2d 951, 962 (Ill. 2002) (not a "deceptive practice" under Illinois Consumer Fraud Act to enforce penalty provisions in car lease because the penalties were clearly set out in lease); *Sklodowski v. Countrywide Home Loans, Inc.*, 358 Ill.App.3d 696, 704, 832 N.E.2d 189, 197 (Ill. App. Ct. 2005) (not a "deceptive practice" under Illinois Consumer Fraud Act for mortgagee not pay interest on escrow funds to mortgagor because the mortgage agreement clearly disclosed mortgagee's policy of not doing so).

The FTC fails to distinguish this authority and without any further analysis, weakly claims the cases are inapplicable because they interpret the Illinois Consumer Fraud Act, not the FTC Act. *See* FTC's Response Brief, p. 18. But the two statutes are interpreted harmoniously. The Illinois Consumer Fraud Act is described as a "little FTC Act." *Ramson v. Layne*, 668 F.Supp. 1162, 1164 (N.D. Ill. 1987). Indeed, the Illinois Consumer Fraud Act contains a specific provision that in construing the Act, "consideration shall be given to the interpretations of the Federal Trade Commission and the federal courts relating to Section 5(a) of the Federal Trade Commission Act." 815 ILCS 505/2 (West 2007). Courts interpreting the Illinois Consumer Fraud Act "have expressly applied the regulations promulgated under Section 5(a) of the [FTC] Act." *Allergy Asthma Technology, Ltd. v. I Can Breathe! Inc.*, 195 F.Supp.2d 1059, 1072 (N.D. Ill. 2002). In fact, the FTC later concedes in its brief that, "Illinois has a consumer protection act similar to the FTC Act." *See* FTC's Response Brief, p. 23. Thus, cases

decided in the context of the Illinois Consumer Fraud Act clearly support the legal principle that articulation of a legal position is ***not*** a deceptive practice under either statute.

The FTC admits that IFC has a colorable legal theory of recovery when it acknowledges that, "In private litigation, finance companies (including IFC) have won some and lost some." *See* FTC's Response Brief, p. 15, fn. 16. Moreover, courts that have examined the "hell or high water" and waiver of defenses clauses contained in the ERAs either have upheld the same or indicated that they may be enforceable, again demonstrating that IFC's position is colorable. *See Liberty Bank, F.S.B. v. Diamond Paint and Supply, Inc.*, 2006 WL 2691719 (Iowa App. Sept. 21, 2006) (enforcing ERA's "hell or high water" clause and granting summary judgment to leasing company); *F.C.V., Inc. v. Sterling National Bank*, 2006 WL 1319822, *6 (D.N.J. May 12, 2006) (in approving putative class action settlement agreement, court acknowledged that the outcome of the litigation is uncertain as "Plaintiffs [lessees] would have to prove [*sic*] overcome numerous, plausible defenses raised by Defendant [leasing company] in its Answer, including its defense that the claims are barred by the parties' contract under a provision commonly known as a "hell or high water" clause.").[9] Thus, because IFC has a

[9] The FTC incorrectly claims that because IFC's cited cases involve different finance companies, they do not support IFC's contention that its claims are colorable because there might be an entirely different set of facts "regarding the closeness of the finance company's connection to NorVergence and its knowledge of underlying fraud or deception." *See* FTC's Response Brief, p. 21, fn. 22. However, IFC's cited cases are still relevant to its contention that its claims are colorable as both the *Liberty Bank* and *Sterling Bank* case deal with the enforceability of the "hell or high water" clauses under UCC Section 2A-407 under principles of pure contract law interpretation, not a leasing company's status as a holder in due course under UCC Section 9-403. Moreover, Illinois has rejected the "close connection" doctrine in the commercial context. *Christinson v. Venturi Construction*, 109 Ill.App.3d 34, 37-38, 440 N.E.2d 226, 228-229 (Ill. App. Ct. 1982)

colorable claim in representing to the Lessees that the "hell or high water" and waiver of defenses clauses are enforceable, its legal position cannot be deceptive.

Moreover, the authority the FTC cites for the proposition that deceptive practices under the FTC Act include misrepresenting legal rights to consumers is easily distinguishable. The FTC's citation to the Fair Debt Collection Practices Act is baseless. *See* FTC's Response Brief, p. 19. A "debt" as defined by the Act is:

> [A]ny obligation or alleged obligation of a consumer to pay money arising out of the transaction in which the money, property, insurance, or services which are the subject of the transaction are primarily for personal, family, or household purposes, whether or not such obligation has been reduced to judgment.

15 U.S.C. § 1692a(5) (West 2007). The Lessees have already represented in the ERAs that, "**[T]he Equipment will not be used for personal, family or household purposes.**" *See* ERAs, p. 1, Group Exhibit 1 to IFC's Motion to Dismiss (emphasis added). Thus, IFC's representations to the Lessees regarding the legal status of the Lessees' debt to IFC under the ERAs are neither covered nor prohibited by the Fair Debt Collection Practices Act. *See Munk v. Federal Land Bank of Wichita*, 791, F.2d 130, 132 (10th Cir. 1986) ("[The Fair Debt Collection Practices] Act does not apply to this debt or to these creditors. This debt was not incurred for 'personal, family, or household purposes.' *See* 15 U.S.C. § 1692a(5).")

The FTC's case law similarly is inapplicable. In *Verity*, ***after*** a full bench trial on the merits, the court concluded that the defendants violated the FTC Act when they represented to consumers that they were legally obligated to pay for internet services provided by the defendants' clients, and these representations were deemed materially false because the individuals had not, in fact, signed up for the services. *Verity*

International, 335 F.Supp.2d at 497. The situation in *Verity* is a far cry from the instant case, where the Lessees executed the ERAs and agreed to their terms. Similarly, *Datacom Marketing* concerned the defendants' practice of trying to collect a purchase price for a directory from individuals who were not informed that they were purchasing the directory and never agreed to make the purchase. *FTC v. Datacom Marketing, Inc.*, 2006 WL 1472644, *4 (N.D. Ill. May 24, 2006). Thus, in both cases, the courts concluded that because the defendants' representations regarding consumers' debt obligations were false because the consumers never agreed to purchase the goods or services, the defendants had no colorable basis to make these claims and violated the FTC Act.

In contrast to the FTC's cited cases, no final determination has been made by any court that: (1) because the ERAs are not "finance leases" and the Lessees did not accept the equipment, IFC cannot enforce the "hell or high water" clauses under Section 2A-407; or (2) because IFC is not a holder in due course, it cannot enforce the ERAs' waiver of defenses clauses under Section 9-403.[10] Absent a final adjudication on the merits that

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[10] There is no final adjudication on the merits as to IFC's status as a holder in due course. As the FTC acknowledges, the judgment entered in *Specialty Optical v. IFC Credit Corporation* is not *res judicata* as to IFC because the decision is currently on appeal. *See* FTC's Response Brief, p. 15, fn. 16. What the FTC fails to recognize is that even if the *Specialty* decision was not appealed, it cannot be *res judicata* as to IFC under Texas law. "In deciding whether to give preclusive effect to state court judgments, federal courts look to state law in the state where the original action was decided." *Studio Art Theatre of Evansville, Inc. v. City of Evansville, Indiana*, 76 F.3d 128, 130 (7th Cir. 1996). "The trial court has broad discretion in determining whether or not to apply the doctrine of collateral estoppel." *Upjohn Co. v. Freeman*, 906 S.W.2d 92, 101 (Tex. App. – Dallas 1995).

The Texas Civil Practice and Remedies Code provides:

> (a) A judgment or a determination of fact or law in a proceeding in a lower trial court is not res judicata and is not a basis for collateral estoppel by judgment in a proceeding in a district court, except that a judgment rendered in a lower court is binding on the parties thereto as to recovery or denial of recovery.
>
> * * * * *

IFC is not a holder in due course, at a minimum, IFC has a colorable legal argument that it can enforce the ERAs' "hell or high water" and waiver of defenses clauses and thus had a right to make its representations to the Lessees.

B. IFC's representation to the Lessees regarding its legal position is not a "deceptive practice."

The FTC argues that IFC made "absolute claims (not mere statement of opinion)" when it told the Lessees that they had an unconditional obligation to pay. *See* FTC's Response Brief, p. 19. These allegations are mere characterizations regarding IFC's communications with the Lessees, and the Court should ignore them. *Reed*, 77 F.3d at 1051. The FTC's attempt to distinguish "claims" versus "opinions" is a distinction without difference as it is impossible to differentiate the two in an adversarial setting. Moreover, as discussed above, because IFC's claims against the Lessees are colorable, IFC's representations to the Lessees cannot be deceptive. If IFC had made representations to the Lessees that they have no defenses after a final adjudication against

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> (c) For purposes of this section, a "lower trial court" is a small claims court, a justice of the peace court, a county court, or a statutory county court.

Tex. Civ. Prac. & Rem. Code, § 31.004 (West 2006) (emphasis added). "[T]he purpose of section 31.004 is to limit the preclusive effect of judgments from courts of limited jurisdiction." *Morrison v. Sports Cars and More, Inc.*, 1995 WL 634361, * 3 (Tex. App. – Dallas 1995). *See also McClendon v. State Farm Mutual Automobile Ins. Co.,* 796 S.W.2d 229, 232 (Tex. App. – El Paso 1990). Both "county courts" and "district courts" are state courts under the Texas Constitution. Tex. Const. Art. 5, §§ 1, 8, 16.

The Specialty Optical Judgment was brought in a county court. *See* Exhibit 58 to the FTC's Motion for Preliminary Injunction. As the Specialty Optical case was brought in a "lower trial court" of limited jurisdiction, pursuant to Section 31.004, its findings of fact and conclusions of law are ***not*** *res judicata* or collateral estoppel, even in another Texas state court, i.e., a Texas district court. Besides "district courts" and the courts that fall under the statute's description of "lower trial courts," there are no other state-level civil trial courts in Texas. Tex. Civ. Prac. & Rem. Code, § 31.004 (West 2007); Tex. Const. Art. 5, § 1. Because the Specialty Optical Judgment was rendered in a county court (and thus a "lower trial court" under the statute), it would not have a preclusive effect in any other Texas state-level civil trial court. Moreover, the only cases in Texas that are binding on appellate courts are published appellate opinions. Tex. R. App. P. 47.7(West 2007); *Carrillo v. State*, 987 S.W.3d 789, 794 (Tex. App. – Amarillo 2003). Thus, Section 31.004 limits the collateral estoppel effect of the Specialty Optical Judgment in ***all*** Texas state courts, both trial and appellate. Accordingly, the Specialty Optical Judgment has no bearing on the instant case.

IFC, then the FTC's claim of "deceptive practice" would have some merit. However, that is not the situation in the instant case. Here, the FTC seeks to hold IFC liable for representations of its legal position ***before*** a final adjudication on the merits.

The FTC's position is patently illogical and unconstitutional. Under this flawed rationale, if a holder of a negotiable instrument sued to enforce a note and articulated to the debtor (both in and out of court) that it was liable to the holder because the holder took assignment of the note in good faith, the holder somehow violates the FTC Act through its articulation of its legal position simply because the FTC believes that the holder was not a holder in due course. Adopting the FTC's sweeping proposition would prevent parties from enforcing their contractual rights and silence any articulation of a legal position prior to adjudication on the merits merely because the FTC may deem that conduct a violation of the FTC Act. Aside from the FTC's arguments being unconstitutional under the First and Fifth Amendments (see *infra*), common sense dictates that the FTC Act was not intended for that purpose, and the Court should reject the FTC's position.

The FTC also relies on the allegations that IFC took assignment of the ERAs in bad faith and argues that, if the Court assumes those allegations to be true, the FTC can turn IFC's statements about its legal rights into deceptive conduct under the FTC Act. This contention is clearly not the law, and the FTC fails to cite any authority to support this proposition. IFC certainly has a right to articulate and defend its legal status and position, and the FTC cannot bootstrap its own allegations regarding IFC's status as a holder in due course into a charge of deceptive conduct. Taken to its logical conclusion, the FTC's position would make every potential litigant subject to a Section 5 charge of

deceptive conduct should the litigant assert its legal rights in some way with which the FTC disagrees. Because IFC's articulation of its legal position cannot be a deceptive practice, Count I fails as a matter of law.

C. IFC did not mislead consumers acting reasonably under the circumstances.

The FTC claims that the Lessees acted reasonably under the circumstances by relying on IFC's representations regarding its legal position, because the Lessees cannot be expected to read and understand the ERAs and seek legal counsel to defend themselves. *See* FTC's Response Brief, p. 22. That the Lessees must read and understand the ERAs' terms is not novel as the law presumes that parties know the contents of contracts they sign. *Heller Financial*, 883 F.2d at 1292; *Rubino*, 324 Ill. App. 3d at 937.

IFC's contention that the Lessees are sophisticated is not at odds with the FTC's allegations. Though the FTC alleged that the Lessees are small businesses, religious, and non-profit organizations, to conclude that the Lessees are unsophisticated or incapable of understanding a two-page contract makes a logical leap that this Court need not accept. *Reed*, 77 F.3d at 1051 (in ruling on a motion to dismiss, the court is not "compelled to accept conclusory allegations concerning the legal effect of facts set out in the complaint"). The FTC's insinuation that the Lessees are unsophisticated is further at odds with the Seventh Circuit's conclusion in *Aliano* that, at least with respect to that particular Lessee, Aliano's cries of a lack of sophistication were meritless. *IFC Credit Corporation v. Aliano Brothers, et al.*, 437 F.3d 606, 610-611 (7th Cir. 2006). That no court has made a ruling on the sophistication of the Lessees as a whole (*See* FTC's

Response Brief, p. 22, fn. 25) is irrelevant; that the Lessees are commercial entities creates a presumption of sophistication. The Seventh Circuit has stated:

> Midwhey then falls back on the claim that they were mere "dairy farmers," not sophisticated businessmen; thus, they should not be held to the standards announced in *Burger King* and *The Bremen* regarding the enforceability of forum-selection clauses. Even if we were to make an exception as to big versus little, or acumen versus naiveté in such circumstances, we would need a great deal more than the bare assertion Midwhey makes. Beyond that, we note that two of the defendant "dairy farmers" are incorporated in the State of Wisconsin, thus indicating that they are a little more worldly than Midwhey's brief implies.

Heller Financial, 883 F.2d at 1291.

Similarly here, though the FTC tries to downplay the Lessees' sophistication, it cannot change the fact that all of the Lessees were business entities. *See* Exhibits 1-23 to FTC's Motion for Preliminary Injunction. Many Lessees have a large number of employees, belying the FTC's contention that the Lessees were "mom and pop" shops in need of assistance. *See e.g.* Exhibit 13, ¶ 3 (95 employees) and Exhibit 10, ¶ 2 (over 65 employees) to FTC's Motion for Preliminary Injunction. Because the FTC's Deception Statement states that the reasonableness of the group that has allegedly been misled must be examined "in light of the knowledge and sophistication of that group," the Court must consider the Lessees' sophistication. FTC Deception Statement (1983) (appended to *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 174 (1984)).[11]

[11] The FTC attempts to purposefully confuse the Court by concluding that *Allen Neurosurgical Associates, Inc. v. Lehigh Valley Health Network*, 2001 WL 41143, *5 (E.D. Penn. 2001), is inapplicable here because the Lessees were not sophisticated like the neurosurgeons in *Allen* and because, as small businesses, the Lessees would generally not have hired counsel before signing the ERAs. *See* FTC's Response Brief, p. 23, fn. 25. IFC does not cite *Allen* for the proposition that the Lessees were sophisticated, or that they should have hired counsel before signing the equipment leases. Rather, IFC cites *Allen* for the proposition that the legal interpretation of a document is not a misrepresentation of fact, and a party of ordinary prudence would be expected to seek legal counsel before relying on such an interpretation. *See* IFC's

The FTC also claims that because the Lessees were not required to doubt the veracity of IFC's express representations, they were somehow misled. The FTC's argument is misplaced as it focuses only on the "materiality" prong of "deception," not whether the practice "is likely to mislead consumers acting reasonably under the circumstances." *Kraft,* 970 F.2d at 314. The FTC wholly ignores the fact that no consumer was "misled" by IFC's representations as nearly all have asserted defenses to IFC's lawsuits and, in many instances, have filed suit against IFC to pursue their own claims that the ERAs are <u>not</u> enforceable as to them. *See Global Stone Co. v. IFC Credit Corporation; C&W Services, Inc v. Commerce Commercial Leasing, LLC et al.*; *Global Inc. v. IFC Credit Corporation; Robert Konkel v. IFC Credit Corporation*; and *William Palumbo Ins. Agency, Inc. v. Irwin Business Finance Corp. et al*, attached to the FTC's Motion for Preliminary Injunction as Exhibit 39, p. 66-136.[12] Because the Lessees were not misled by IFC's alleged misrepresentations, the FTC's claim for deception fails as a matter of law.

5. The FTC has failed to state a claim for "unfair practices" under Count II.

In Count II of its Complaint, the FTC claims that IFC's acceptance of and collection on the ERAs is an "unfair practice." In disputing IFC's contention that the FTC failed to state a claim for an "unfair practice," the FTC argues: (1) IFC knew or should have known that the ERAs "falsely describe their purpose" of telecommunications services; (2) the Lessees were injured by IFC's collection on the ERAs; (3) the Lessees'

Motion to Dismiss, p. 26. The representation that should have prompted the Lessees to defend themselves or seek legal counsel here is that the Lessees have an unconditional obligation to make payments, not that they should have sought legal counsel when signing the documents.

[12] The Court may take judicial notice of these court decisions without converting IFC's Motion to Dismiss to a Motion for Summary Judgment. *See Doherty*, 75 F.3d at 325, n. 4; *Davis*, 70 F.3d at 372, n. 3.

alleged injury could not have been reasonably avoided; and (4) there is no countervailing benefit to the Lessees. *See* FTC's Response Brief, pp. 25-26. The FTC's contentions are without merit.

First, as discussed above, the FTC's contention that the ERAs are services agreements and not equipment leases is belied by the terms of the ERAs themselves, which trump the allegations of the Complaint. *Thompson*, 300 F.3d at 754. Second, there is no "substantial injury" to the Lessees as the Lessees ***agreed*** to make payments to IFC, regardless of NorVergence's performance, when they signed the ERAs. That the Lessees now must spend time and money litigating against IFC regarding their contractual obligations is a risk that any party undertakes when it enters into a contract and thereafter refuses to fulfill its obligations. *U.S. v. Cieslowski*, 410 F.3d 353, 360 (7th Cir. 2005) ("Allocating risks about future developments is, after all, what contracts are all about."); *Chicago Steel Rule and Die Fabricators Co. v. ADT Security Systems, Inc.*, 327 Ill.App.3d 642, 651, 763 N.E.2d 839, 846 (Ill. App. Court. 2002) ("We find nothing unreasonable about the fact that the commercial parties of equal bargaining power were free to allocate the risk of loss by contract.") That the risk was realized and fell upon the Lessees is not a reason for the Court to alter the ERAs' terms. *Berryman Transfer and Storage Co., Inc.*, 345 Ill. App. 3d 859, 863, 802 N.E.2d 1285, 1288 (Ill. App. Ct. 2004) (a court will not change a contract merely because it or one of the parties comes to dislike its provisions).

Third, the FTC's contention that the Lessees could not have reasonably avoided the "injury" here because they were entitled to rely on NorVergence's representations that services would continue even if NorVergence went out of business and because they

had no reason to expect a finance company would enforce the ERAs in the absence of services is without merit. *See* FTC's Response Brief, p. 25-26. Contracting parties are presumed to know the contents of contracts they sign. *Heller Financial,* 883 F.2d at 1292; *Rubino*, 324 Ill. App. 3d 931 at 937. The contracts provide that the ERAs can be assigned, that the Lessees' payment obligations under the ERAs are unconditional, and that the Lessees cannot raise any claims or defenses it may have against NorVergence against any subsequent assignee. *See* ERAs, Group Exhibit 1 to IFC's Motion to Dismiss. Thus, the Lessees cannot feign ignorance of the ERAs' terms when it suits them now. Moreover, all businesspeople understand that if a bankruptcy occurs, business relationships – including phone service – would likely be disrupted or even terminated.

Notably, the FTC does not address IFC's argument that the Lessees cannot claim to have been fraudulently induced by NorVergence's representations since they were given the opportunity to read the contracts and thus could have discovered the alleged fraud for themselves. *Regensburger v. China Adoption Consultants, Ltd.*, 138 F.3d 1201, 1207 (7th Cir. 1998); *see also Pierce v. Atchison Topeka & Santa Fe Railway Co.*, 65 F.3d 562, 569 (7th Cir. 1995). Thus, because the Lessees could have avoided the "injury" here (*i.e.*, risks allotted to the Lessees pursuant to the ERAs' terms) by simply not executing the ERAs or contracting with another company, Count II fails as a matter of law.

6. The FTC has failed to state a claim for "unfair practices" under Count III.

In Count III of its Complaint, the FTC claims that IFC's filing of suits against the Lessees in Illinois (pursuant to the ERAs' forum selection clause, which has been upheld by nearly every appellate court that has examined it, including the Seventh Circuit) is an

"unfair practice." In response to IFC's contention that the FTC failed to state a claim for an "unfair practice," the FTC argues the following: (1) *FTC v. Spiegel, Inc.* allows the FTC to challenge IFC's actions, despite the Seventh Circuit's unanimous approval of the forum selection clause in *IFC Credit Corporation v. Aliano Brothers*; (2) *Aliano* is not contrary to the FTC's claims because *Aliano* left open the possibility of not enforcing the clause due to fraud; (3) the Lessees were injured by IFC's filing of suits; (4) the Lessees could not have reasonably avoided in the injury here as they had no control over IFC's actions; and (5) there is no countervailing benefit to the Lessees. *See* FTC's Response Brief, pp. 26-29. The Court should reject the FTC's contentions.

First, the FTC claims that "[t]he unfairness of distant forum collection suits under the FTC Act is well established," citing only to *FTC v. Spiegel, Inc.* *See* FTC's Response Brief, p. 26. *Spiegel* is entirely distinguishable from the instant case. In *Spiegel*, the Seventh Circuit held that the defendant's use of the Illinois long-arm statute in small collection suits was a violation of the FTC Act. *Spiegel, Inc. v. Federal Trade Commission*, 540 F.2d 287 (7th Cir. 1976). In contrast, IFC sued the Lessees here based on their ***express written consent*** in the ERAs' forum selection clause to be sued where IFC's principal offices are located, *i.e.*, Illinois. *See* ERAs, Group Exhibit 1 to IFC's Motion to Dismiss, Applicable Law paragraph. The FTC cannot ignore this crucial distinction to manufacture an "unfairness" claim against IFC. *See* 15 U.S.C. § 45(n) (West 2007) (a practice is not "unfair" if the "consumer" could have avoided the injury, *i.e.* not agreed to the forum selection clause in writing).

Now realizing the weakness of its untenable position that the "floating" forum selection is vague and unenforceable, the FTC attempts to recharacterize its argument.

The FTC claims that though it does not challenge forum selection clauses in general, it takes issue with IFC's choice to sue the Lessees in a distant forum, despite its alleged knowledge of NorVergence's practices and the fact that every ERA is allegedly worthless. *See* FTC's Response Brief, p. 28, fn. 34. The FTC's characterization is a distinction without difference. Because IFC sued the Lessees in Illinois pursuant to the ERAs' valid and enforceable forum selection clause, the FTC cannot find fault with IFC's filing of suit in Illinois without necessarily attacking the forum selection clause. However, as the forum selection clause has been unequivocally upheld by the Seventh Circuit, the FTC's attempted battle against the forum selection clause is without merit.

The FTC's contention that the forum selection clause "has been ruled unenforceable by a number of state courts" is disingenuous. *Id.*, p. 28. With the exception of one lone appellate court and one trial court whose ruling is currently on appeal[13], all other state and federal appellate courts that have examined the clause have found it valid and enforceable. *Aliano*, 437 F.3d 606; *Pure Solutions, Inc. v. IFC Credit Corporation*, 2006 WL 1316974 (11th Cir. May 15, 2006); *Preferred Capital, Inc. v. Associates in Urology*, 453 F.3d 718 (6th Cir. 2006); *Secure Financial Services, Inc. v. Popular Leasing USA, Inc.*, 391 Md. 274, 892 A.2d 571 (Md. 2006); *Sterling National Bank v. Eastern Shipping Worldwide, Inc.*, 2006 WL 3592323 (N.Y. App. Div. 2006). The Seventh Circuit in *Aliano* held that the forum selection clause was enforceable under both Illinois and federal law, and that decision is binding in this Circuit. *Aliano*, 437 F.3d 606.

[13] *Preferred Capital, Inc. v. Power Engineering Group, Inc.*, 112 Ohio St.3d 429, 860 N.E.2d 741 (Ohio 2007) (finding ERAs' forum selection clause unenforceable); *IFC Credit Corporation v. Rieker Shoe Corporation*, Case No. 06-1310, pending in Illinois Appellate Court, First District.

Second, the FTC claims that *Aliano* does not prevent it from bringing its Count III unfairness claim against IFC because *Aliano* left open the possibility of invalidating the clause if the Lessee could demonstrate that the clause was "procured by fraud." The FTC surmises that its allegations that the Lessees "were deceived into signing a complex array of contracts they could not understand" suffices. *See* FTC's Response Brief, p. 28. But this contention ignores the black letter rule that general fraud allegations are insufficient to invalidate the forum selection clause, as the party opposing enforcement must show that the inclusion of the clause *itself* was the product of fraud. *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 n. 14, 94 S.Ct. 2449, 2457 n. 14 (1974). *See also American Patriot Ins. Agency, Inc. v. Mutual Risk Management, Ltd.*, 364 F.3d 884, 889 (7th Cir. 2004). Because the FTC does not allege that the inclusion of the forum selection clause itself was a product of fraud, its fraud allegations are irrelevant. Moreover, though the Seventh Circuit was aware of the FTC's default judgment against NorVergence, it deemed the judgment inconsequential to its analysis. *Aliano*, 437 F.3d 611. Finally, the FTC's position also ignores the fundamental principle that contracts induced by fraud are voidable, not void, such that the ERAs are fully enforceable by IFC under Section 9-403, even in the face of a "personal defense" like fraudulent inducement. 810 ILCS 5/3-305 (a)(1)(iii) and Comments 1 & 2 (West 2007).

Third, the FTC claims that because it has made the conclusory allegation that the Lessees were injured by IFC's filing of suits in Illinois, Count III withstands challenge. *See* FTC's Response Brief, p. 29. The Court cannot accept this conclusory allegation, nor can it accept unsupported allegations of fact. *Reed*, 77 F.3d at 1051; *McLeod*, 258 F.3d at 614. Contrary to the FTC's claim, IFC's contention that the same "injury" of defending a

lawsuit would apply even if IFC had sued the Lessees in their home states is not mere speculation, but common sense. Defending against a lawsuit incurs costs, regardless of its location. Thus, the Lessees could not avoid the "injury" of responding to IFC's complaints even if the suits were filed in their home states.

Fourth, the FTC's claim that the Lessees could not have reasonably avoided the injury because IFC's decision to sue was "beyond the consumer's control or ability to negotiate" ignores the Lessees' ***consent*** to be sued in a foreign jurisdiction. *See* FTC's Response Brief, p. 29. The Lessees could control whether they would enter into the contracts that gave IFC the right to do so in the first place. That the Lessees were allegedly unaware of the forum selection clause is without consequence as the Seventh Circuit has noted:

> When the Supreme Court in *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 111 S.Ct. 1522, 113 L.Ed.2d 622 (1991), held enforceable a forum-selection clause printed on the back of the cruise ticket, it brushed aside the arguments that many consumers don't read the fine print in their contracts and do not appreciate the significance or perhaps even the meaning, of a forum-selection clause. See also *IFC Credit Corp. v. Aliano Bros. General Contractors, Inc.*, 437 F.3d 606, 610 (7th Cir. 2006).

Rud v. Liberty Life Assurance Co. of Boston, 438 F.3d 772, 776 (7th Cir. 2006). The FTC cannot now ask the Court to assume a paternalistic attitude towards the Lessees when its own policy on unfairness provides:

> Normally we expect the marketplace to be self-correcting, and we rely on consumer choice – the ability of individual consumers to make their own private purchasing decisions without regulatory intervention – to govern the market. We anticipate that consumers will survey the available alternatives, choose those that are most desirable, and avoid those that are inadequate or unsatisfactory.

FTC Unfairness Statement (1980) (appended to *International Harvester Co.*, 104 F.T.C. 949, 1070 (1984)). Thus, the Lessees could have avoided the "injury" of being sued in Illinois by either not signing the ERAs or altering the forum selection clause.

Finally, the FTC's claim that enforcement of the forum selection clause benefits leasing companies like IFC to the detriment of the Lessees is without merit. *See* FTC's Response Brief, p. 29-30. As the Seventh Circuit recognized, the use of a forum selection clause reduces transactional costs, a savings which is passed down to the Lessees in the form of lower prices to the Lessees. *Aliano*, 437 F.3d at 610, 612-613. Moreover, contrary to the FTC's claim that the Lessees will be "effectively precluded" from raising defenses against IFC if sued in Illinois, the Lessees are not precluded from defending suit as they can (and have) found attorneys in Chicago to litigate these matters. Because IFC's filing of suits against the Lessees in Illinois cannot be an "unfair practice," Count III of the Complaint fails as a matter of law.

7. The FTC's Complaint infringes on IFC's constitutional rights.

The FTC claims that IFC's in and out-of-court statements to the Lessees that the Lessees have an unconditional obligation to make payments to IFC are not entitled to constitutional protection. *See* FTC's Response Brief, p. 30. The FTC concludes that because it has alleged that IFC's speech is deceptive, IFC cannot raise its constitutional defense.

The FTC's argument is circular. As discussed above, for there to be a "deceptive practice" under Count I, the FTC must allege that the statement the Lessees have no defenses against IFC is both false and likely to mislead the Lessees acting reasonably under the circumstances. The Lessees were not misled by IFC's representations because

nearly all have raised defenses or filed suit against IFC; the exhibits attached to the FTC's Motion for Preliminary Injunction demonstrate the same and contradict the FTC's allegations.

IFC's representations to the Lessees additionally cannot be "deceptive" as IFC has a colorable legal claim to enforcing the ERAs. The FTC admits the same when it acknowledges that, "In private litigation, finance companies (including IFC) have won some and lost some." *See* FTC's Response Brief, p. 15, fn. 16. Moreover, courts that have examined the "hell or high water" and waiver of defenses clauses contained in the ERAs either have upheld the same or indicated that they may be enforceable, again confirming that IFC's position is colorable. *See Liberty Bank, F.S.B. v. Diamond Paint and Supply, Inc.*, 2006 WL 2691719 (Iowa App. Sept. 21, 2006); *F.C.V., Inc. v. Sterling National Bank*, 2006 WL 1319822, *6 (D.N.J. May 12, 2006). For the FTC to claim that IFC's articulation of its legal position is "deceptive" presumes a final adjudication on the merits that IFC took assignment of the ERAs in bad faith. Because no such adjudication exists, IFC's claims against the Lessees – and its legal position that the "hell or high water" and waiver of defenses clauses are enforceable – must be colorable as a matter of law and thus cannot be classified as "deceptive" speech. Accordingly, IFC's speech is entitled to constitutional protection.

A. The FTC's Complaint violates IFC's First Amendment rights.

The FTC's restrictions on IFC's speech violate the First Amendment through its application of the FTC Act to IFC. As discussed in IFC's Motion to Dismiss, under the four-prong test articulated in *Central Hudson Gas & Elec. Corp. v. Public Service Commission of New York*, 447 U.S. 557, 100 S.Ct. 2343 (1980), the FTC's prohibition

fails to pass intermediate scrutiny. First, IFC's speech is protected by the First Amendment because: (a) there is no final adjudication on the merits that IFC took assignment of the ERAs in bad faith, and thus IFC has a colorable legal argument in stating that the ERAs' terms are enforceable; (b) the articulation of a party's legal position cannot be deceptive. *Randazzo*, 262 F.3d at 671; *Harris Trust*, 1989 WL 117984, *5; *Notaro Homes*, 309 Ill.App.3d at 259; *Hoseman*, 322 F.3d at 477, n. 2.

Second, the FTC's governmental interest in prohibiting deceptive speech, though substantial, is inapplicable because here, the FTC is seeking to prohibit non-deceptive speech. Third, the FTC's restriction does not directly advance the governmental interest because IFC's speech is not deceptive, and the likelihood of any Lessee being tricked by the speech is minimal given the nature of the adversarial proceedings. Finally, the FTC's prohibition is more extensive than necessary because it restricts IFC's articulation of its legal position without meaningfully protecting the Lessee from "deceptive" speech (because IFC has an absolute right to sue to protect its property). Accordingly, Counts I and II of the FTC's Complaint, as it intends to apply sections of the FTC Act to IFC's articulation of its legal position in and out of court, violate IFC's First Amendment right to free speech and, therefore, must be dismissed.

B. The FTC's Complaint violates IFC's substantive due process rights and the right to petition the courts.

A party has a Fifth Amendment due process right to have access to the civil courts and the right to be heard; the right to make arguments with a reasonable basis in law or fact in defense or in support of its claims; and the right to defend its property in the courts. *Tennessee v. Lane*, 541 U.S. 509, 124 S.Ct. 1978, 1988 (2004); *Snyder v. Nolen*, 380 F.3d 279, 291 (7th Cir. 2004), quoting *Johnson v. Atkins*, 999 F.2d 99, 100 (5th Cir.

1993); *Boddie v. Connecticut*, 401 U.S. 371, 91 S.Ct. 780, 785-86 (1971). Because IFC has the constitutional right to access to the courts, to petition the courts, to defend its property in court, and to make colorable legal arguments (both for breach of contract and fraudulent inducement against the Lessees), the FTC cannot prohibit IFC from articulating its legal position or suing the Lessees under the ERAs.

The FTC attempts to distinguish the authority cited by IFC by arguing that the cases involve instances in which the courts themselves imposed barriers upon plaintiffs or prospective plaintiffs, not a situation in which a law enforcement agency like the FTC is preventing alleged statutory violations. *See* FTC's Response Brief, p. 32. The FTC essentially argues that because it can declare otherwise proper speech and conduct "unfair and deceptive" under the FTC Act, it can remove constitutional protections that the speech and conduct would otherwise enjoy. However, that the FTC is a law enforcement agency is irrelevant as to whether it can trample on IFC's constitutional rights, much like the police cannot violate an accused criminal's constitutional rights merely to make an arrest. Because Count I and II of the FTC's Complaint infringe on IFC's constitutional due process rights, they must be dismissed.

WHEREFORE, IFC CREDIT CORPORATION respectfully requests that this Court grant its Motion to Dismiss Plaintiff Federal Trade Commission's Complaint for Injunctive and Equitable Relief.

Respectfully Submitted,

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