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

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

Appendix C to FTC's Response to IFC's Motion to Dismiss

LIST OF APPENDICES

These are materials cited by the FTC that may not be readily available from online sources.

Appendix C

C - 1 *Rosenblum's World of Judaica, Inc. v. IFC Credit Corp., Inc.*, Memorandum Opinion and Order, No. 04 CH 18187, Slip op. (Ill. Cook Cty. Cir. Ct. Chancery Div. Dec. 28, 2005)

C - 2 *People of the State of Illinois v. Leasecomm Corporation*, Complaint, No. 03CH09154 (Ill. Cook Cty. Cir. Ct. Chancery Div. filed May 29,2003)

C - 3 *State v. IFC Credit Corp.*, Complaint, No. 07CC-002301 (Mo. St. Louis Cty. Cir. Ct. filed June 6, 2007)

Appendix C-1

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT – CHANCERY DIVISION

ROSENBLUM'S WORLD OF JUDAICA, INC. and AVROM FOX, individually and as the representatives of a class of similarly-situated persons,
Plaintiffs,

v.

IFC CREDIT CORPORATION, INC.,
Defendants.

No. 04 CH 18187

Judge James Henry

MEMORANDUM OPINION AND ORDER

Defendants IFC Credit Corporation, Inc. ("IFC") filed a motion to dismiss the Plaintiff's First Amended Complaint, pursuant to Sections 2-615 and 2-619 of the Illinois Code of Civil Procedure, 735 ILCS 5/2-615 and 735 ILCS 5/2-619. Plaintiffs, Rosenblum's World Of Judaica, Inc. and Avrom Fox ("Rosenblum's"), in their Complaint allege two counts: Count I, Violation of the Illinois Consumer Fraud and Deceptive Practices Act ("IFCA") and Count II, Declaratory Judgment. IFC's Motion to Dismiss seeks to dismiss Count I pursuant to Section 2-615 and Count II pursuant to Section 2-619.

I. First Amended Complaint

This is a class action claim brought on behalf of all persons in Illinois who leased network computer equipment from the now defunct entity known as Norvergence, Inc. Plaintiff Rosenblum's allege the equipment was documented in a form rental agreement identified as the Norvergence Rental Agreement. Norvergence apparently resold telecommunication services to small businesses throughout Illinois. Norvergence claimed that the use of its equipment would result in discounts of 30 to 60% of the cost of a landline phone, cell phone and high-speed internet services from the major telecommunication service providers, such as Qwest or T-Mobile.

The discounts were to be obtained through the use of equipment rented from Norvergence, called "Matrix" boxes. These boxes would be connected to the landline phone, cell phone and high-speed internet service of each individual claimant. The re-wiring and re-routing was to result in savings of 30 to 60% or even free unlimited local and long distance calling on their respective landline telecommunication systems.

The "Matrix" boxes were designed by a non-party manufacturer and were not designed for the purpose stated by Norvergence. Rosenblum's claims that the supposed "Matrix" box does not even exist. Rather, the box sold was actually an Adtran router box, which is incapable of doing any of the things Norvergence represented. Many of the individual Plaintiffs signed consumer personal guarantees for the equipment. In addition, Norvergence sold each lessee a total solution package to reduce telecommunications costs.

The Norvergence leases ran for up to 60 months time and then Norvergence would assign all or a portion of the lease to a lease financing company, like the Defendant, IFC. In October 2003, IFC and Norvergence signed a Master Agreement, where IFC purchased the Equipment Rental Agreements by paying Norvergence a discounted portion of the total rental price. IFC and Norvergence amended their Master Agreement in March 2004 and June 2004.

On March 25, 2004, Avrom Fox, Rosenblum's President, executed a Norvergence Equipment Rental Agreement ("Rental Agreement"). The Rental Agreement was made in conjunction with a service plan, which included unlimited wireless calling for four cell phones, portability of cell phone numbers from the prior provider, landline phones with unlimited local and long distance calling and high speed internet. Sometime around April 2004,[1] this lease was assigned to IFC. No telephone communication service was ever provided to Rosenblum's by Norvergence. Rather, the box delivered to Rosenblum's, that appeared to be a "Matrix" box, was never installed and has never functioned. However, Rosenblum's sent monthly payments to IFC to avoid default and acceleration.

Rosenblum's allege that the equipment is completely worthless and has been of no use to Rosenblum's. Rosenblum's claim that IFC is aware of Norvergence's

[1] Apparently in error, Plaintiff's alleged in their First Amended Complaint that the lease was assigned to IFC sometime in April 2003.

misrepresentations of the leased equipment and continues to attempt to enforce the lease agreements. In July 2004, Norvergence sought Chapter 11 bankruptcy protection after being forced into court by an involuntary petition for Chapter 11 bankruptcy by three Leasing Company creditors.

Count I of Rosenblum's First Amended Complaint alleges a violation of the Illinois Consumer Fraud and Deceptive Practices Act, 815 ILCS 505/1. *et seq.*, claiming Norvergence engaged in a course of trade or commerce that constitutes unfair and deceptive acts or practices under 815 ILCS 505/2.

Count II seeks a Declaratory Judgment that: (a) the Norvergence Rental Agreement is unconscionable and unenforceable; (b) the Norvergence Rental Agreement's waiver of claims and defenses as against the original lessor is void and unenforceable because the Defendants knew or should have known at the time they took assignments from Norvergence that Norvergence was insolvent; (c) the provision in the Norvergence Rental Agreement regarding recovery of the entire remaining rental balance in the event of any default is a penalty and thus unenforceable; (d) Rosenblum's is not bound by its acceptance because it revoked any acceptance; (e) the provisions of the rental agreement are unconscionable; (f) IFC is not a holder in due course; (g) the Rental Agreement is usurious and thus void; (h) the Rental Agreement violates the Uniform Commercial Code ("UCC"), and is thus void; and (i) the Rental Agreement is not a "lease" under the UCC and it is not a "finance lease."

II. SECTION 2-615 AND 2-619 LEGAL STANDARDS

Granting or denying a section 2-615 motion to dismiss addresses the sound discretion of the trial court. See In re Estate of Casey, 222 Ill. App. 3d 12, 19 (1st Dist. 1991). The only question presented by such a motion is whether the Plaintiff has alleged sufficient facts, which if proven, would entitle him to relief. See Kirchner v. Greene, 294 Ill. App. 3d 672, 679 (1st Dist. 1998). To avoid dismissal under this section, a pleading must set forth a legally recognized cause of action, and plead facts bringing the claim within that cause of action. See Vincent v. Williams, 279 Ill. App. 3d 1, 15 (1st Dist. 1996).

A section 2-615 motion attacks the legal sufficiency of the pleading only. See Bryson v. New America Publications, 174 Ill. 2d 77, 86 (1996). Accordingly, all well pled facts in the pleading and those contained in the exhibits attached thereto are taken as true for purposes of the motion. See id. However, conclusions of law or factual conclusions, which are unsupported by allegations of specific facts, are not taken as true. See Vincent, 279 Ill. App. 3d at 5.

When the legal sufficiency of a complaint is challenged on a Section 2-619 motion to dismiss, all well-pleaded facts and reasonable inferences are accepted as true. See Swavely v. Freeway Ford Truck Sales, 298 Ill. App. 3d 969, 972 (1st Dist. 1998). Subsection 2-619(a)(9) permits dismissal where the asserted claim is barred by other affirmative matter avoiding the legal effect of or defeating the claim. See Klein v. DeVries, 309 Ill. App. 3d 271, 273 (2d Dist. 1999). "Affirmative matter" encompasses any defense other than the negation of the essential allegations of the claim. See id. The initial burden rests with the defendant but the burden shifts to the plaintiff who must establish that the defense is unfounded or requires the resolution of an essential element of material fact before it is proved. See id. If after considering the pleadings and supporting affidavits, the court finds that the plaintiff has failed to carry the shifted burden, the motion to dismiss based on affirmative matter may be granted. See id.

III. ANALYSIS

Plaintiffs allege that: (1) IFC purchased long-term Equipment Rental Agreements ("lease agreements") for "Matrix" boxes that never functioned and were obtained by Norvergence through fraud; (2) IFC knew of or at least suspected it was purchasing fraudulently obtained leases (as evidenced by the exorbitant price of the Matrix box and the complaints by customers); (3) IFC continued to purchase the lease agreements through the month prior to Norvergence's forced filing of Chapter 11 bankruptcy; (4) Rosenblum's would not have purchased the "Matrix" box had they known of the defect; and (5) Rosenblum's were damaged as a result of signing a lease agreement that was worthless and did not offer the services Norvergence claimed it would provide. Rosenblum's seek relief under the ICFA, 815 ILCS 505/1 *et seq.* These allegations are directed solely at Defendant IFC. The Court will first address the sufficiency of Plaintiffs' allegations with respect to the ICFA and then address the Declaratory Judgment claim.

A. COUNT I – ILLINOIS CONSUMER FRAUD ACT

In order to plead a private cause of action under the ICFA, a plaintiff must allege: (1) a deceptive act or practice by the defendant; (2) the defendant's intent that the plaintiff rely on the deception; (3) the occurrence of the deception in the course of conduct involving trade or commerce; and (4) actual damage to the plaintiff; (5) proximately caused by the deception. See Oliviera v. Amoco Oil Co., 201 Ill.2d 134, 149 (2002). An omission or concealment of a material fact in the conduct of trade or commerce constitutes consumer fraud. 815 ILCS 505/2; Macinac v. Arcadia National Life Insurance Co., 271 Ill. App. 3d 138, 141 (1995).

A complaint alleging a consumer fraud violation "must be pled with the same particularity and specificity as that required under common law fraud." Connick v. Suzuki Motor Co., 174 Ill.2d 482, 501 (1996). Pleading specificity requires that the plaintiff allege "the identity of the person making the misrepresentation, the time, place, and content of the misrepresentation, and the method by which the misrepresentation was communicated..." Schiffels v. Kemper Financial Servs., 978 F.2d 344, 352 (7th Cir. 1992).

Section two of the ICFA forbids unfair or deceptive acts, or practices, including the use of deception, fraud, misrepresentation or the omission or concealment of any trade or business with the intent that others rely on the deception. People ex rel. Daley v. Grady, 192 Ill.App.3d 330, 332 (1989). Therefore, to fall within the purview of section two, it must be shown that IFC is engaged in a trade or commerce and in unfair or deceptive acts in the conduct of that trade or commerce. See People ex rel. Hartigan v. Knecht, 216 Ill.App.3d 843, 853 (1991).

Rosenblum's assert that IFC seeks to enforce the Rental Agreements even though they are void, and this is deceptive or unfair practice on the part of IFC. Rosenblum's cite to People ex rel. Hartigan v. Knecht Services, Inc., 216 Ill.App.3d 843 (1991), for the proposition that it is a deceptive or unfair practice to collect on a void obligation. The court in Hartigan determined that the defendant, who was in the business of home repair, had charged for work not done, padded time records, performed unnecessary repairs and other similar wrongs. The court determined that these acts amounted to prohibited unfair business practices. The court followed the standard set by the Supreme Court in Federal

Trade Comm'n v. Sperry & Hutchinson Co., 405 U.S. 233 (1972), for determining whether the conduct complained of rises to the level of an unfair trade practice: (1) whether the practice offends public policy; (2) whether it is immoral, unethical, oppressive or unscrupulous; or (3) whether it causes substantial injury to consumers. Hartigan, 216 Ill.App.3d at 854.

Here, the Amended Complaint alleges that IFC is culpable for its attempts to enforce payment from Rosenblum's. This Court has stated previously that the actions that could ascribe culpability to IFC are the allegations that, near the time of the Rosenblum's lease and two to three months later, IFC altered their reserve agreement with Norvergence due to complaints by consumers. Under the test set out in Hartigan, that alone does not suffice as a claim for unfair trade practice.

However, Rosenblum's have not only alleged that IFC altered their reserve agreement with Norvergence, but include in their complaint that IFC knew that: (1) Rosenblum's and other Norvergence customers never actually received Matrix boxes; (2) customers who purchased lease agreements had no access to landline phone, cell phone, or internet services through the boxes received; (3) those who did receive the alleged "Matrix" boxes never received any use from them; (4) Norvergence misrepresented equipment capabilities to customers; and (5) the total rent payments in the lease agreements vastly exceeded the value of the product. If IFC participated in the fraud and unethical practice that caused substantial injury to Norvergence customers, then such allegations would rise to the level of unfair trade practice as set out in Hartigan.

IFC asserts that Rosenblum's have only made conclusory allegations that cannot survive a motion to dismiss. IFC states that this case is analogous to Jackson v. South Holland Dodge, Inc., 197 Ill. 2d 39 (2001). In Jackson, the plaintiff brought a class action lawsuit against South Holland Dodge car dealership. 197 Ill. 2d at 41. Plaintiff had purchased a Dodge vehicle from the defendant and also purchased an extended service warranty for $1,099. Id. The contract stated that the entire $1,099 would be paid to Chrysler for the extended service warranty. Id. However, the defendant did not actually pay the full sum listed in the contract to Chrysler, but instead retained a portion of the $1,099. Id. Defendant South Holland Dodge then assigned the retail installment contract to Chrysler. Id. at 42. The Supreme Court held that there were "no specific factual allegations that, prior to the assignment of the financing statement, Chrysler directly participated in a scheme with the dealership to misrepresent facts to the plaintiff." Id. at 52. The Supreme Court further stated that the plaintiff's "conclusory allegations of 'actual knowledge'" were nothing more than a claim that Chrysler knowingly received the benefits of another's fraud. Id.

Jackson can be distinguished from the case at hand. In Jackson the plaintiff based her claim on Chrysler's alleged omission in its installment contacts of a provision required for sellers by the Federal Trade Commission, in consumer credit contracts. 197 Ill. 2d at 42. Furthermore, the plaintiff alleged that Chrysler was liable because the manner in which the price was disclosed was deceptive and misleading, thereby violating the ICFA. Id. The Supreme Court in Jackson held that Chrysler's conduct complied with the federal Truth in Lending Act ("TILA") and was, therefore, not responsible for the misrepresentations made by the dealer. Id. at 57.

Here, there is no allegation that IFC failed to disclose certain information or that the contracts did not contain certain provisions. Unlike the circumstances found in Jackson, IFC has not asserted that because it is in compliance with TILA it cannot be liable under the ICFA. Despite IFC's argument that the allegations made by Rosenblum's are merely conclusory and are not sufficient to withstand a Section 2-615 motion to dismiss, Rosenblum's have brought forth sufficient facts, which if proven, would entitle them to relief. As set forth herein, this Court is of the opinion that sufficient facts have been alleged to survive a 2-615 motion. Discovery will be helpful to provide additional factual input.

This Court recognizes that knowingly accepting the benefits of a deceptive practice does not constitute Consumer Fraud liability. Zekman v. Direct Am. Marketers, Inc., 182 Ill.2d 359 (1998). However, allegations of participation in misrepresentations can be sufficient for a Consumer Fraud claim. See Saltzman v. Enhanced Serv. Billing, Inc., 348 Ill.App.3d 740 (1st Dist. 2004).

In Saltzman, the defendant Infodex was a telecommunications information service provider that furnished information when a consumer would phone a particular "900" number. 348 Ill.App.3d at 742. The plaintiff alleged receiving telephone bills from Ameritech that included a charge for defendant Infodex's service, but claimed he did not know anything about the service and had never used the service. Id. at 743. The charge was listed on his phone bill as coming from ESBI, another defendant in the case. Id. Plaintiff's complaint alleged that ESBI violated section two of the ICFA by adding charges to customer's telephone bills for which it had no contract or authorization to do so. Id. ESBI argued that it was simply performing a data processing function and that ESBI had no way of knowing whether a charge on a customer's telephone bill was erroneous. Id. at 744.

In Saltzman the court distinguished the circumstances from those found in Zekman v. Direct Am. Marketers, Inc., 182 Ill.2d 359 (1998), and held that plaintiff's complaint alleged more than merely an allegation that the ESBI knowingly received the benefits of Infodex's deceptive practices. Id. at 749. The court noted that the complaint alleged it was ESBI's practice to receive billing information from Infodex that included evidence of authorization and "place the 'bogus' charge on the victim's telephone bill." Id. This action constituted participation in the misrepresentation, allowing plaintiff's IFCA claim to stand.

Similarly, Rosenblum's allege that IFC knew of the fraudulent practices performed by Norvergence. Rosenblum's contend that in March and June 2004, IFC amended their agreement with Norvergence due to customers never receiving Norvergence equipment they paid for and customers not receiving services promised by Norvergence. IFC's response to these issues was to raise the amount of money they held back from Norvergence on each lease form from 5% to 25%. IFC also required Norvergence to notify them about whether customers received the equipment and services. In addition, IFC included in the amended agreement that Norvergence had to notify IFC of the default rate of customers, or the number of customers who did not receive services and then refused to make payments. Furthermore, the amendments included a clause as to IFC's options if Norvergence went into default in their payments to IFC. If default of payments occurred, IFC required the reversion of leases back to Norvergence. Such allegations, if proven, may demonstrate participation in the misrepresentations made by Norvergence.

IFC cites to several cases to support its proposition that Illinois law provides that it had no duty of active inquiry into the conduct of Norvergence and therefore, cannot be held liable for fraud on the part of Norvergence. Citing to Chicago Titled & Trust v. Walsh, 34 Ill.App.3d 458 (1975), IFC argues that a purchaser of commercial paper need only look to the face of a document to determine whether the transaction is sound. In Walsh, an escrow was opened at Chicago Title & Trust Company ("Chicago Title") by two attorneys. The escrow was not to be amended without one of the attorneys present. 34 Ill.App.3d at 461. However, Chicago Title accepted an amendment signed only by one of the two attorneys, allowing the escrowee to accept directions from Jack Walsh as to dispursements. Id. The amendment allowed Walsh to act fraudulently. Id. Walsh funded the escrow with a forged check and Chicago Title was induced to issue bank drafts to creditors of Walsh, including Gale Marcus and Max Munson. Id.

The court in Walsh held that Marcus and Munson were holders in due course because there was no evidence that Marcus or Munson should have been suspicious of the Chicago Title drafts. Id. at 468. The court noted that the creditors had no duty of active inquiry and further stated that the circumstances should have reassured Marcus and Munson of the validity of the instruments.

In contrast, though IFC had no duty to actively inquire as to the validity of the agreements between Norvergence and its customers, IFC is not free from all responsibility when "warnings" are apparent. See e.g., Winter & Hirsch, Inc. v. Passarelli, 122 Ill.App.2d 372 (1970) (stating in *dicta* that a party purchasing negotiable paper at a great discount has a duty to inquire into the initial transaction to determine if the borrower has a defense to the note). Rosenblum's allege that IFC had knowledge that the Rental Agreements between Norvergence and its customers were fraudulent. IFC amended its agreements with Norvergence on two occasions, seemingly due to problems with Norvergence not furnishing the equipment and services it promised to its customers. IFC was also on notice of the number of customers that refused to pay under the Rental Agreements because they did not receive equipment or services. Therefore, the First Amended Complaint is sufficient to surpass a motion to dismiss.

B. COUNT II – DECLARATORY JUDGMENT

Arguing under 735 ILCS 5/2-619, IFC contends that the Rental Agreement's Waiver of Defense provision bars Rosenblum's from seeking a declaratory judgment that the Rental Agreement is unenforceable. IFC asserts four primary arguments: (1) under

Article 2A of the Uniform Commercial Code ("UCC"), Rosenblum's lease is irrevocable upon its acceptance of the equipment and the lease's "hell or high water" clause requires payment regardless of the equipment's condition; (2) the agreement is a lease agreement subject to Article 2A and not a security interest; (3) IFC is a holder in due course and therefore, the waiver of defense clause is enforceable; and (4) the lease is not unconscionable.

First, IFC asserts that Article 2A of the UCC states that promises under a lease contract become irrevocable upon the lessee's acceptance of the goods. Section 2A-407 provides:

> Irrevocable promises; finance leases.
>
> (1) In the case of a finance lease that is not a consumer lease the lessee's promises under the lease contract become irrevocable and independent upon the lessee's acceptance of the goods.
>
> (2) A promise that has become irrevocable and independent under subsection
> (1):
>
> (a) is effective and enforceable between the parties, and by or against third parties including assignees of the parties; and
>
> (b) is not subject to cancellation, termination, modification, repudiation, excuse, or substitution without the consent of the party to whom the promise runs.
>
> (3) This Section does not affect the validity under any other law of a covenant in any lease contract making the lessee's promises irrevocable and independent upon the lessee's acceptance of the goods.

810 ILCS 5/2A-407 (2005). IFC argues that the lease's "hell or high water" clause, which requires payment regardless of the equipment's condition, operates to bar any claims made by Rosenblum's. IFC asserts that, according to Section 2A-407 and the "hell or high water" clause, equipment functionality is not a consideration when determining the obligation to pay under the Rental Agreement. Therefore, IFC contends it is entitled to payment regardless of the condition of the equipment.

A "hell or high water" clause of a lease is an unconditional obligation on the part of the lessee to pay rent regardless of problems the lessee has with the leased equipment. See Siemens Credit Corp. v. Kakos, No. 94 C 5365, *3 (Jan. 24, 1995); see also Co. Interstate Corp. v. The CIT Group/Equip. Fin., Inc., 993 F.2d 743, 749 (10th Cir. 1993). In essence, rent payments continue to be paid, come hell or high water, without any offset. Co. Interstate Corp., 993 F.2d at 749. These clauses are strictly enforced because without strict enforcement, when a finance company loans to a lessee, its only security would be repossession of equipment with a diminished value. Id. However, courts uniformly enforce such clauses only "[w]here a lease is valid." Siemens Credit Corp., No. 94 C 5365, *3.

IFC cites to Bus. Info. Group, Inc. v. Bell Atlantic Sys. Leasing Int'l, Inc., No. 90 C 20291 (Oct. 8, 1992), to support the proposition that Illinois courts enforce "hell or high water" provisions. In Business Information Group, plaintiff leased computer equipment from the defendant. No. 90 C 20291 at *6. The lease between the two parties included a "hell or high water" clause. Id. at *5. The plaintiff refused to make further payments on the lease when the defendant refused to move the equipment to plaintiff's new location or to allow plaintiff to relocate the computers. Id. at *4. The court enforced plaintiff's obligation to pay because its responsibility of payment was independent of the sales agreement. Id. at *5. Essentially, the court held that even if the defendant was wrong to withhold consent to move the leased equipment, the lease agreement required payments to continue. Id. at *5.

In contrast, here, Rosenblum's contend that the lease is not a valid lease. Therefore, the "hell or high water" clause that is included in the Norvergence lease may be unenforceable. Furthermore, Rosenblum's alleged fraud and deceit on the part of Norvergence and IFC. Such a claim may defeat the provision requiring unconditional payment included by Norvergence in its leases. See Co. Interstate Corp. v. The CIT Group/Equip. Fin., Inc., 993 F.2d at 749 (holding that in the absence of fraud or deceit, the parties should be held to their agreement).

IFC also cites to Siemens Credit Corp. v. Kakos, No. 94 C 5365, *3 (Jan. 24, 1995), to support its argument that Rosenblum's should pay IFC under the Norvergence lease agreement. In Kakos, the defendant, a dentist, entered into an equipment lease agreement with Siemans Credit Corporation, a financing arm of Seimans Corporation, for state-of-the-art dental equipment. No. 94 C 5365, *1. Siemans was not the vender of the equipment but the record is silent regarding what type of agreement Siemans had, if any, with the vender of the equipment. Id. The "hell or high water" clause in defendant's lease obligated him to pay all amounts due regardless of any dissatisfaction with the equipment. Id. at *4. The clause also stated that Seimans Credit was only a financier in the transaction and disclaimed all warranty liability. Id. The lease directed the defendant to make claims arising out of problems with the equipment to the vendor directly. Id.

The court in Kakos denied Siemans Credit's motion for summary judgment, holding that an issue of fact existed as to whether the vendor and Seimans Credit operated as alter egos of one another and whether the vendor breached its warranty. Id. at *9. The court also noted that the lease was valid and that no misrepresentations were made about the terms of the lease. Id. at *6.

Here, there are sufficient allegations to support Rosenblum's theory that the lease for equipment was not valid. In addition, misrepresentations were purportedly made by Norvergence to Rosenblum's and to the members of the putative class. Moreover, Rosenblum's had no contact with IFC prior to signing the lease agreement with Norvergence and they were never informed that IFC would be taking over the lease agreement until IFC contacted them directly to demand payment. Therefore, the "hell or high water" clause in the Norvergence Rental Agreement is not unconditionally enforceable and does not, on its face, require Rosenblum's to pay.

Second, Rosenblum's contend that the Rental Agreement does not fall within the purview of Article 2A because it is a security interest and not a lease. IFC asserts that the Rental Agreement is a true lease and should be governed by Article 2A of the UCC.

A "lease" is defined as the:

> Transfer of the right to possession and use of goods for a period in return for consideration, but a sale, including a sale on approval or a sale or return, retention or creation of a security interest, or license of information is not a lease.

810 ILCS 5/2A-103(j). A security interest is defined as "an interest in personal property or fixtures which secures payment or performance of an obligation." 801 ILCS 5/1-201(37). Section 1-201 further provides that determining whether an agreement is a lease of a security interest is determined by the facts of each case. 801 ILCS 5/1-201(37). A transaction is a security interest if "the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee," and "the original term of the lease is equal to or greater than the remaining economic life of the goods." Id.

In the present case, Rosenblum's assert that the Rental Agreement meets two requirements of a security interest: (1) the Rental Agreement states that it cannot be terminated by Rosenblum's; and (2) the Rental Agreement's original term of five years is equal or greater than the remaining economic life of the goods. These items are sufficiently pled and will await further developments during discovery.

Third, Rosenblum's argue that under Article 9-403 of the UCC, the waiver of defense clause is unenforceable because the Rental Agreement was induced by fraud or because IFC is not a holder in due course. IFC contends that it had no notice of claims or defenses when IFC took the assignment and, because it has no duty of active inquiry, it is a holder in due course.

A holder in due course is an innocent third party. Kedzie and 103rd Currency Exchange, Inc. v. Hodge, 156 Ill.2d 112, 122 (1993). The holder in due course rule is a concept intended to facilitate commercial transactions because it eliminates the need for complex investigation of the nature of the drafting of an instrument or the nature for which an instrument is initially exchanged. Hodge, 156 Ill.2d at 122. A true holder in due course takes an instrument in good faith, for value, and lacks knowledge of the circumstances surrounding the initial exchange of the instrument. See 810 ILCS 5/3-302.

The Court adopts Rosenblum's argument that the question as to whether IFC was on notice, or whether IFC is a holder in due course, requires the resolution of an essential element of material fact before it is proved. Here, Rosenblum's allege that IFC is not a holder in due course for several reasons, including allegations that IFC knew: (1) the rented equipment was worth only a small fraction of the stated price; (2) that the equipment could not function as claimed by Norvergence and Norvergence need to provide services for the equipment to purportedly function; (3) customers were refusing to pay under the Rental Agreements; and (4) Norvergence was having difficulties because IFC increased its cash retention in its agreements with Norvergence. Therefore, the question of whether IFC was a holder in due course, or on notice as to Norvergences' practices, is not properly determined at this stage.

Fourth, with regard to Rosenblum's unconscionability claim, IFC contends that this Court cannot rewrite contract terms to make an agreement more equitable. IFC argues that, because parties are free to contract, this Court cannot relieve Rosenblum's simply because of a bad bargain.

Unconscionability can be either procedural or substantive or a combination of both. Frank's Maintenance & Engineering, Inc. v. C.A. Roberts Co. and Leland Tube Co., Inc., 86 Ill.App.3d 980, 989 (1980). "Procedural unconscionability consists of some impropriety during the process of forming the contract depriving a party of a meaningful choice." Frank's Maintenance & Engineering, Inc., 86 Ill.App.3d at 989. Any provision limiting the defendant's liability must have been bargained for or brought to the purchaser's attention. Id. at 990. Substantive unconscionability concerns the question of whether the terms themselves are commercially reasonable. Id.

In the present case, Rosenblum's and the potential member class signed Rental Agreements for a piece of electronic equipment. Representations were made concerning the nature and usage of the device. Allegedly, the representations made by Norvergence were false. Due to the nature of the equipment a person, such as the agent for Rosenblum's, would not have the ability to learn or discover the true nature of the instrument. It is clear that the weaker party to the transaction was Rosenblum's. In addition, the true effect of the language does not appear to be readily apparent to Rosenblum. The Rental Agreements were on printed forms with no apparent ability to change or alter the terms. The only inserted information related to the nature of the equipment, the monthly lease payment, and the length of the lease term. The warranties and the individual terms do not appear to be negotiable.

Rosenblum's appear to make sufficient allegations for unconscionability. However, there must be an examination of the Rental Agreement's terms to determine if they are harsh, one sided, or oppressive. See Larned v. First Chicago Corp., 264 Ill.App.3d 697, 700 (1994). As stated in their First Amended Complaint, the price paid over the lease term exceeded the value of the equipment. Furthermore, in signing the Rental Agreement, Rosenblum's and other members of the putative class waived any claims they may have had as to the operative ability of the equipment. Finally, this Court previously stated that the impact of the movable jurisdiction provisions render the Rental Agreements such that no average person would enter into such an agreement.

Therefore the motion to dismiss as to Count II is denied.

IV. ORDER

IT IS HEREBY ORDERED:

A. Defendants' Motion to Dismiss is DENIED to the extent outlined in this Memorandum of Opinion and Order;

B. Defendants are given 28 days from the date of this Order to file an Answer to Plaintiff's Complaint, with discovery to proceed;

C. The matter is set for a status conference on March 29, 2006 at 9:45 a.m.

JAMES F. HENRY
Entered: DEC 28 2005
Circuit Court - 1526

Judge James F. Henry
Circuit Court of Cook County, Illinois
County Department, Chancery Division
Calendar "6"

Appendix C-2

Attorney No. 99000

IN THE CIRCUIT COURT OF COOK COUNTY, ILLINOIS
COUNTY DEPARTMENT, CHANCERY DIVISION

PEOPLE OF THE STATE OF ILLINOIS,

Plaintiff

vs.

LEASECOMM CORPORATION, a wholly owned subsidiary of MICRO FINANCIAL INCORPORATED, MICRO FINANCIAL INCORPORATED, a Massachusetts Corporation,

Defendants.

No.: 03CH09154

FILED
MAY 2 9 2003
DOROTHY BROWN
CLERK OF CIRCUIT COURT

COMPLAINT FOR INJUNCTIVE AND OTHER EQUITABLE RELIEF

1. This is a civil action brought in the public interest by the Attorney General on behalf of the PEOPLE OF THE STATE OF ILLINOIS, pursuant to the Illinois Consumer Fraud and Deceptive Business Practices Act, 815 ILCS 505/1 et. seq., ("Consumer Fraud Act"). The Defendants in this action are Massachusetts corporations engaged primarily in the business of leasing and financing small business opportunities and other items provided to individuals through a network of vendors throughout the United States. This action alleges that during the course and conduct of their business, the Defendants have committed unfair or deceptive acts or practices, in violation of Section 2 of the Consumer Fraud Act, 815 ILCS 505/2.

I.
JURISDICTION AND VENUE

2. The Attorney General is authorized to bring this action pursuant to Section 7 of the Consumer Fraud Act, 815 ILCS 505/7. Section 7 of the Consumer Fraud Act states in relevant part as follows:

> Whenever the Attorney General...has reason to believe that any person is using, has used, or is about to use any method, act or practice declared by this Act to be unlawful, and that proceedings would be in the public interest, he or she may bring an action in the name of the People of the State against such person to restrain by preliminary or permanent injunction the use of such method, act or practice. The Court, in its discretion, may exercise all powers necessary, including but not limited to: injunction, revocation, forfeiture or suspension of any license, charter, franchise, certificate or other evidence of authority of any person to do business in the State; appointment of a receiver; dissolution of domestic corporations or association suspension or termination of the right of foreign corporations or associations to do business in this State; and restitution.
>
> In addition to the remedies provided herein, the Attorney General...may request and the Court may impose a civil penalty in a sum not to exceed $50,000 against any person found by the Court to have engaged in any method, act or practice declared unlawful under this Act. In the event the court finds the method, act or practice to have been entered into with the intent to defraud, the court has the authority to impose a civil penalty in a sum not to exceed $50,000 per violation.

815 ILCS 505/7 (West 2000).

3. Venue is proper in Cook County, Illinois in that Defendants or Defendant's agents transact business in such county.

II.
PLAINTIFF

4. The plaintiff is the PEOPLE OF THE STATE OF ILLINOIS represented by the Attorney General LISA MADIGAN who brings this action in the public interest.

III.
DEFENDANTS

5. The Defendant, MICROFINANCIAL INCORPORATED ("MicroFinancial"), is a Massachusetts corporation with corporate headquarters located at 10M Commerce Way, Woburn, Massachusetts. MICROFINANCIAL stock is publicly traded on the New York Stock Exchange.

6. The Defendant, LEASECOMM CORPORATION ("Leasecomm"), is a wholly-owned subsidiary of MicroFinancial with a principal place of business also located at 10M Commerce Way, Woburn, Massachusetts.

IV.
DEFINITIONS FOR PURPOSES OF THIS COMPLAINT

7. "Customer" is any natural person who is individually liable to pay Leasecomm for financing, either directly or indirectly, *e.g.*, as a cosignor, guarantor, proprietor, or signatory general partner.

8. "Business venture" includes purported profit making ventures (*e.g.*, multilevel marketing programs, pyramid schemes, buyers' clubs, coupon clipping programs, investment opportunities, etc.), regardless of how participation in the venture is characterized (*e.g.*, as investors, members, donors, etc.), seminars, or promotions that seek to induce customers to make money through business or investment, or similar intangible items.

V.
STATUTES VIOLATED

9. Section 2 of the Illinois Consumer Fraud Act, states in relevant part as follows:

> Unfair methods of competition and unfair or deceptive acts or practices, including but not limited to the use or employment of any deception, fraud, false pretense, false promise, misrepresentation or the concealment, suppression or omission of any material fact, with intent that others rely upon the concealment, suppression or omission of such material fact, or the use or employment of any practice described in section 2 of the 'Uniform Deceptive Trade Practices Act', approved August 5, 1965, in the conduct of any trade or commerce are hereby declared unlawful whether any person has in fact been misled, deceived or damaged thereby. In construing this section 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 (2000).

VI.
DEFENDANTS' BUSINESS ACTIVITIES

10. LEASECOMM'S principal business since at least 1997 has been providing financing through contracts it calls "leases" to individuals and small businesses. The contracts purport to be leases for items such as point-of-sale credit card swiping machines ("POS machines") and Internet-based, online payment systems ("virtual terminals"), which have often been sold as part of a purchase of a business opportunity or profit making venture. The business opportunities and profit making ventures include Internet web malls, multilevel marketing programs, pyramid schemes, medical billing software, coupon clipping programs, and similar, often worthless get-rich-quick schemes that consumers have been duped into buying by deceptive practices of the business venture sellers. A typical lease requires total payments between $3,000

to $4.000 over a three to four year period.

11. Customers usually make no up-front payment for their business venture purchase. Instead, the business venture vendors, acting as LEASECOMM'S agents for selling financing, procure customers' signatures on LEASECOMM financing contracts for all or most of the cost of the business venture. After making a successful sales pitch, the vendor presents the LEASECOMM contract to the customer amid the various papers the customer signs. Customers have little opportunity to read or understand the complex LEASECOMM contract, which the vendors usually do not explain to them. Even if customers did read all the fine print in the contract, it is unlikely that they would understand the rights and remedies that the fine print attempts to take away from them. LEASECOMM expressly prohibits the vendors from changing any of the contract's boilerplate terms. Vendors, however, frequently make assertions that certain provisions will not apply to the customer.

12. Typically, the only payment the vendor receives for the business opportunity is a lump-sum payment from LEASECOMM. In some cases, LEASECOMM splits the payment between the vendor and a supplier of other goods or services associated with the business opportunity, like the provider of a POS machine or merchant account services. Thus, LEASECOMM is actually financing the whole business venture.

13. Often times, based on the sales pitch by the vendors, customers believe that they are signing a financing agreement for the entire business venture they are purchasing. Even though the lease amount is often the full price of the business venture package plus finance charges, the lease purports to only finance a POS machine or virtual terminal, a computer software license, or some other item that is an incidental part of the business opportunity. For

example. a typical sales contract lists many items being sold as part of a business venture (*e.g.*, training, web site design. customer leads, a manual. forms, software, merchant account) for a specified price per month (*e.g.*, $70) over a specified term (e.g., 4 years). The corresponding LEASECOMM contract in this example would also be for the $70 per month and over 4 years, but would state as the item being financed only one component of the business venture (*e.g.*, a POS machine). Nonetheless, frequently what the customers believe is that for payments of $70 per month over a 4 year period, they are buying the entire business venture.

14. LEASECOMM does not allow its vendors to fill in finance contracts with a truthful description of the business venture. LEASECOMM makes the finance contract look like an equipment lease, because Uniform Commercial Code Article 2A ("UCC Art. 2A") equipment lease provisions are significantly more favorable to lessors than the provisions relating to non-lease finance contracts. Finance contracts for business opportunities and other general intangible items do not qualify as UCC Art. 2A leases.

15. For web-based business ventures, the specified item financed in the LEASECOMM lease is often a "virtual terminal." This is not a tangible piece of equipment that can be owned by LEASECOMM as a lessor or the customer. Rather, it is simply the setting up of an online P.O.S. system and the information necessary to access that account. Virtual terminals are typically available from merchant account providers and processors, who then charge the customer a commission when charges or debits are made, plus a small monthly fee.

16. The customer will receive a contract for merchant account services included in the papers the vendor provides, along with the sales contract for the principal items being sold (*e.g.*, training, web site design, customer leads, a manual, forms, software, merchant account) and the

LEASECOMM contract. The virtual terminal service contracts are generally cancelable by either party upon relatively short notice (*e.g.*, one month). Typically, the "lease" that LEASECOMM writes for the virtual terminal is non-cancelable for 36-48 months.

17. The deception continues when LEASECOMM and the vendors fail to disclose to customers material facts about the transaction that would lead them to question whether they should enter into the business venture transaction or the finance contract with LEASECOMM. LEASECOMM and its vendors do not explain the involvement of LEASECOMM in the transaction so that customers are often unaware that they are entering into a financing transaction with a third party. They also do not explain that the contract makes the customer's obligation to pay LEASECOMM absolute. This obligation to pay is based on the customer's acceptance of the POS machine, virtual terminal, or other item financed. In the contract, the customer is agreeing to waive defenses, including the defense of fraud in the inducement. Finally, the vendors do not explain that the contract provides that any disputes under the contract will be resolved in a Massachusetts court, a forum which in most instances is distant from the customer's residence. These provisions may not be enforceable under applicable contract laws.

18. LEASECOMM drafts its lease contracts to ensure that customers pay even when the agreement to enter into the lease or the underlying business venture transaction is induced by the vendors' misrepresentations or fraud, or when the products or services fail to perform as represented. Most lease contracts contain a provision that tells customers that they cannot assert any defense or counterclaim:

> I fully recognize your [Leasecomm's] right to enforce the lease free from any current or future defenses, offsets or counterclaims.

Most lease contracts also contain a second provision that sets the location for filing collection suits in Massachusetts, regardless of where the customer resides or signed the contract. A typical form of that provision is:

> The Parties hereby . . . consent and submit to the jurisdiction of the Courts of the Commonwealth of Massachusetts and express[ly] agree to such exclusive forum for the bringing of any suit, action or other proceeding arising out of their obligations hereunder, and expressly waive any objection to venue in any such Courts . . .

Another provision requires that customers agree to automatic debiting of their bank accounts and requires that customers sign a personal guarantee of the lease contract. Additionally, quite often the obligation to LEASECOMM does not end after the end of the lease term. A provision in the lease automatically renews the lease agreement for an additional year, unless the customer notifies LEASECOMM thirty (30) days prior to the end of the lease term and returns the leased equipment.

19. LEASECOMM knows or should know that many of its vendors engage in deceptive practices to sell their business ventures. LEASECOMM employees maintain a close relationship with its vendors. LEASECOMM uses a computerized system to track delinquent accounts, default rates, and customer complaints of vendor fraud or misrepresentation. The default rate with respect to particular business ventures often exceeds 30%, and with some vendors has exceeded 50%. LEASECOMM also receives large numbers of customer complaints about misrepresentation or fraud concerning these vendors. Despite possessing evidence of serious problems with vendors, LEASECOMM rarely terminates a vendor. Instead, it simply reduces the payment it makes to the vendor, retaining a larger share of the customers' payments for itself.

20. LEASECOMM does not apply the usual finance industry standards for granting credit. First, the value of the equipment purportedly leased by LEASECOMM has no relationship to the value of the lease. POS terminals, which LEASECOMM leases for as much as $4,000,

have a retail value of approximately $400 and wholesale cost of approximately $250. Virtual terminals, leased for the same amount, have a retail value of approximately $300 or less. Second, the credit worthiness of the customer is rarely used to deny credit. Instead, LEASECOMM applies a matrix for rating both the vendor and the customer to set a rate for the lease.

21. LEASECOMM imposes a loss and damage waiver fee. LEASECOMM claims that this fee is equivalent to an insurance on the product or equipment leased. This fee, however, is typically not equivalent to the fair market value of insuring the product or equipment. Furthermore, LEASECOMM imposes this fee on intangible items such as virtual terminals and business opportunities. Additionally, LEASECOMM fails to clearly and conspicuously disclose the amount of the loss and damage waiver fee to customers prior to the signing of the contract.

22. LEASECOMM'S approach to debt collection is very aggressive. It uses the contract provisions described in Paragraph 18, above, to the fullest extent possible to obtain payment from customers and obtain judgments, if necessary. This is true even when the customers have been defrauded and received nothing of value.

23. LEASECOMM is rarely responsive to customers' disputes or claims of fraud against vendors. It relies heavily on the wording of the contract to tell customers that they have no defenses to LEASECOMM'S demand for payment. For example, collectors will point out that the customer accepted a POS machine and that was the only product named in the lease. When the customers argue that the lease really financed an entire business opportunity that was fraudulent, and the POS machine was worthless without the rest of the package, the collectors will still insist that obligation to pay in full is absolute and that the customers have no defenses.

24. One example of how LEASECOMM treated complaints of fraud involved

InfoDirect. a vendor that ran a pyramid scheme. Its organizers made their money by requiring the purchase of overpriced computers, financed by LEASECOMM, to participate in the scheme. According to LEASECOMM'S own complaint records, the computers, if delivered at all, were typically low-end or used and defective models leased for $3,300. The total lease volume was $5.2 million. Of the 1,882 deals, 1,483 went into default, most early in the lease term.

25. LEASECOMM wrote letters to InfoDirect complaining about the poor payment rate. Nonetheless, it continued to accept new leases for nearly a full year after it had notice from customer complaints and defaults that a serious problem existed with the product delivered. LEASECOMM also sued one-third of the InfoDirect customers in Massachusetts courts for non-payment, utilizing its venue waiver contract provision.

26. Another example involves one of LEASECOMM'S largest vendors for virtual terminal business opportunities at seminars, Executive Credit Services. This company accounted for $16 million of business during 1999-2000, with nine thousand customers and a default rate of over 30%. LEASECOMM'S internal records show many complaints about software and web sites never working. LEASECOMM rejected virtually every claim. An example of a "reason" for rejecting a claim was:

> [Eighty-three] 83 year old lessee claims he was misled. [Lessee] signed a non-cancelable lease agreement/merchant acct application ext all docs showed what the charges were for each/ it states right on the lease that if the person does not understand the lease they should seek legal advice (sic).

The fact that Executive Credit Services sold its business opportunities at seminars means that customers had little chance to read over all the purchase and finance documents, and no opportunity to consult with a lawyer before signing them.

27. Another example involves Roma computer, a company selling worthless website business ventures. LEASECOMM financed the computers that customers purchased, ostensibly

to access their website. One customer complained that she "received the equipment, but never used it; still has equipment; was under the impression after seminar that they would get a website and could make lots of money." [Cryptic spellings from Leasecomm's complaint database expanded for readability.] The customer also complained about not receiving a expected printer. LEASECOMM denied the complaint completely because "the free printer has nothing to do with the lease agreement." LEASECOMM simply ignored the complaint about the worthless website business venture.

28. Contrary to representations by LEASECOMM, customers have a number of substantive defenses that could be raised, particularly where business ventures or other intangible items are financed. The most significant is that business ventures or other intangible items are not subject to being leased under UCC Art. 2A and that, therefore, the leases may be voidable or unenforceable in whole or part. At the very least, under applicable contract law, those provisions of the lease that Leasecomm claims require payment regardless of performance or fraud may be unenforceable and customers may have other defenses, such as that the customers did not actually accept the products or that their entry into the contract was induced by fraud or deception. They also may have counterclaims based on the EFTA.

29. Customers rarely have the opportunity to raise any defenses. LEASECOMM regularly files its collection suits in Massachusetts, despite the fact that most of the customers reside in other states. LEASECOMM has sued over 27,000 customers in the past three years in Massachusetts. Few of the customers can afford the expense of litigation in a distant forum and nearly all cases have ended in default judgments. Thus, customers have no real opportunity to raise defenses to the validity of the contract.

30. Even customers who do obtain counsel are hampered by the misleading

LEASECOMM contracts. Courts may take individual contracts at face value unless evidence exists that the contract is part of a pattern and practice of fraud and deception. Given the amounts in controversy, typically under $5,000, it would be extremely difficult for customers' lawyers to develop the evidence to show LEASECOMM'S regular practice of incorrectly describing what was financed. Making complex arguments about the inappropriate use of UCC Art. 2A by LEASECOMM would also be very costly. Finally, the potential witnesses for the customer are likely to be in the customer's local area and not in the Massachusetts jurisdiction. Thus, customer challenge to the distant forum clause in the LEASECOMM'S contracts is difficult.

31. LEASECOMM aggressively enforces its judgments in the customers' local forum. With a judgment already entered, it is almost impossible for customers to challenge LEASECOMM in the subsequent judgment enforcement actions. Had LEASECOMM filed the suits in the local forum in the first instance, customers might have been able to appear and present a defense, either with an attorney or on their own.

32. LEASECOMM adds to the customer injury by imposing high collection fees, not only for late payments, but for every collection call it makes and letter it sends. These fees provide significant profits to LEASECOMM and grossly exceed the cost of collection to LEASECOMM. On the LEASECOMM lease agreement, a provision provides that LEASECOMM will charge the lessee $5.00 per collection call and letter. LEASECOMM sends lessees multiple collection letters, even though, the lessee has filed a complaint disputing the bill. Furthermore, LEASECOMM customer service agents make multiple calls to lessees. Evidence exists that customer service agents even make multiple calls to a lessee on the same day. LEASECOMM supports this practice by awarding bonus pay to its customer service agents when

the agents collect amounts from customers. Moreover, LEASECOMM frequently fails to clearly and conspicuously identify the basis for fees imposed on its invoices. Thus, in many cases, by the time LEASECOMM commences collection in court, the amount sought substantially exceeds the total payments due under the lease.

33. LEASECOMM customer service agents during collection calls frequently harass or threaten customers into paying LEASECOMM. Customer service agents tell customers that if they do not pay LEASECOMM, will garnish their wages, call the police on them, report them to a credit reporting agency, and/or sue them in court in Massachusetts. Furthermore, customer service agents use abusive language.

VII.
VIOLATIONS OF ILLINOIS CONSUMER FRAUD ACT

COUNT I

34. The Plaintiff re-alleges all preceding paragraphs of this complaint and incorporates them herein.

35. In numerous instances, in connection with the financing of small business ventures, LEASECOMM represents, expressly or by implication, directly or indirectly, that the finance contract the customer is entering into with LEASECOMM finances all or a substantial portion of the customer's purchase of the business venture.

36. In truth and in fact, in most or all cases the finance contract, by its terms, finances only discrete equipment or services associated with the business venture, such as a credit card swiping terminal or a virtual terminal.

37. Therefore, the representations set forth in Paragraph 35 above are false or misleading and constitute deceptive acts or practices in violation of Section 2 of the Consumer Fraud Act.

COUNT II

38. The Plaintiff re-alleges all preceding paragraphs of this complaint and incorporates them herein.

39. In numerous instances, in connection with the financing of small business ventures, LEASECOMM represents, expressly or by implication, directly or indirectly, that it is financing the customer's purchase of a business venture.

40. LEASECOMM fails to disclose:

a. That the financing agreement is with LEASECOMM and not with the business venture vendor.

b. That the financing agreement purports to make the obligation to pay LEASECOMM absolute and unrelated to the terms, conditions, or performance of any other agreement, between the consumer and the business venture vendor, and that this agreement may be unenforceable under applicable contract law.

c. That the obligation to pay LEASECOMM in full is based entirely upon acceptance of a credit card swiping machine or virtual terminal.

d. That LEASECOMM'S contract requires or has the effect of requiring that customers waive all defenses that they might have, including, but not limited to, fraud in the inducement of the contract, and that this provision may be unenforceable under applicable contract law.

e. That any disputes concerning the financing agreement will be resolved in a forum distant from the customer's place of residence.

41. These facts would be material to consumers in their purchase or use of the product. The failure to disclose these facts, in light of the representation made in Paragraph 40 above, is a deceptive act in violation of Section 2 of the Consumer Fraud Act.

COUNT III

42. The Plaintiff re-alleges all preceding paragraphs of this complaint and incorporates them herein.

43. In numerous instances in connection with the financing of business ventures, LEASECOMM represents, expressly or by implication, directly or indirectly, that customers have waived all defenses, or are precluded from raising any defenses or counterclaims, including defenses of fraud in the inducement or that material provisions of the financing contract are unenforceable.

44. In truth and in fact, in numerous instances, customers have and can raise defenses and counterclaims, including defenses of fraud in the inducement or that material provisions of the financing contract are unenforceable.

45. Therefore, the representations set forth in Paragraph 43 are false or misleading and constitute deceptive acts or practices in violation of Section 2 of the Consumer Fraud Act.

COUNT IV

46. The Plaintiff re-alleges all preceding paragraphs of this complaint and incorporates them herein.

47. In numerous instances, in connection with the financing of small business ventures, LEASECOMM'S practices of including in its finance contracts provisions authorizing it to file lawsuits in venues other than the customer's place of residence or the location where the customer executed the contract, and of filing lawsuits under finance contracts in venues other than the customer's place of residence or the location where the customer executed the contract, are likely to cause substantial injury that cannot be reasonably avoided, and are not outweighed by countervailing benefits to consumers or competition.

48. Therefore, LEASECOMM'S practices, as alleged in paragraph 47 above, are

unfair and violate Section 2 of the Consumer Fraud Act.

COUNT V

49. The Plaintiff re-alleges all preceding paragraphs of this complaint and incorporates them herein.

50. In the course of providing financing to consumers, defendants have regularly conditioned the extension of credit on the consumers signing a contract that includes compulsory electronic funds transfers from accounts established primarily for personal, family, or household purposes, in violation of Section 2 of the Consumer Fraud Act.

COUNT VI

51. The Plaintiff re-alleges all preceding paragraphs of this complaint and incorporates them herein.

52. The defendants have harassed or threatened customers through their collection practices. Furthermore, the collection fees grossly exceed the cost of collections.

53. Therefore, LEASECOMM'S practices, as alleged in paragraph 52 above, are unfair and violate Section 2 of the Consumer Fraud Act.

CONSUMER INJURY

54. Consumers throughout the United States including Illinois consumers, have suffered substantial monetary loss as a result of the Defendants' unlawful acts or practices. In addition, the Defendants have been unjustly enriched as a result of their unlawful practices. Absent injunctive relief by this Court, the Defendants are likely to continue to injure consumers and to harm the public interest.

55. The Court, in the exercise of its equitable jurisdiction, may award other ancillary relief to remedy injury caused by Defendants' violations.

PRAYER FOR RELIEF

Plaintiff requests that this Court enter an order:

1. Finding that Defendants have engaged in trade or commerce within the meaning of Section 2 of the Consumer Fraud Act.
2. Finding that Defendants have engaged in unfair or deceptive acts or practices in the conduct of trade or commerce, in violation of Section 2 of the Consumer Fraud Act;
3. Enter judgment against defendants and in favor of the PEOPLE OF THE STATE OF ILLINOIS, for each violation alleged in this complaint.
4. Permanently enjoining and restraining defendants from engaging in acts and practices that violate the Illinois Consumer Fraud Act, including but not limited to the unlawful acts and practices above;
5. Awarding such relief as this Court finds necessary to redress injury to consumers;
6. Requiring Defendants to pay all costs for the prosecution and investigation of this action, as provided by Section 10 of the Consumer Fraud Act, 815 ILCS 505/10;
7. Providing such other and further relief as justice and equity may require

RESPECTIVELY SUBMITTED:

LISA MADIGAN
ILLINOIS ATTORNEY GENERAL
STATE OF ILLINOIS

BY:______________________________
CHARLES G. FERGUS, CHIEF
CONSUMER FRAUD BUREAU

Attorney No. 99000

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312-814-3945

Appendix C-3

IN THE CIRCUIT COURT OF THE COUNTY OF ST. LOUIS
STATE OF MISSOURI
TWENTY-FIRST JUDICIAL CIRCUIT

07CC-002301

STATE OF MISSOURI ex rel.
JEREMIAH W. (JAY) NIXON,
ATTORNEY GENERAL

Plaintiff,

vs.

IFC CREDIT CORPORATION
a Illinois corporation,

Defendant.

SERVE:

Registered Agent:
C T Corporation System
208 South Lasalle Street, Suite 814
Chicago, IL 60604

Cause No. 07CC-002301

Division: 19

19

2007 JUN -6 AM 8:03
CIRCUIT CLERK

PETITION FOR PRELIMINARY AND PERMANENT INJUNCTIONS, RESTITUTION, CIVIL PENALTIES AND OTHER EQUITABLE RELIEF

COMES NOW Plaintiff State of Missouri, by and through its Attorney General Jeremiah W. (Jay) Nixon, and states as follows:

INTRODUCTION

1. This action is brought pursuant to Missouri's Merchandising Practices Act, ("MMPA"), Chapter 407 RSMo.,[1] requesting Temporary and Permanent Injunction relief,

[1] All statutory references are to Mo. Rev. Stat. (2000), as presently amended, unless otherwise indicated.

including rescission of contracts, cessation of collections, restitution, and other equitable relief, arising from Defendant IFC Credit Corporation's ("IFC") unfair and deceptive practices.

2. Defendant IFC's conduct alleged herein, arose in the course of its financing the sales of telecommunication services by NorVergence, Inc., ("NorVergence"), a New Jersey corporation. A default judgment was entered against NorVergence in the United States District Court for the District of New Jersey, in *FTC v. NorVergence, Inc.*, Docket No. CV-04-5414-DRD ("NorVergence Judgment"), on July 22, 2005. The Court found that NorVergence had violated Section 5 of the FTC Act, 15 U.S.C. § 45. NorVergence is also a debtor in a Chapter 7 bankruptcy proceeding in that district (Docket No. Bkr-04-32079-RG).

PARTIES

3. Jeremiah W. (Jay) Nixon is the duly elected, qualified, and acting Attorney General of the State of Missouri and bring this action in his official capacity pursuant to Chapter 407.

4. Defendant IFC Credit Corporation ("IFC") is an Illinois corporation with its principal place of business located at 8700 Waukegan Road, Morton Grove, Illinois 60053. Defendant transacts business in the State of Missouri.

JURISDICTION

5. This Court has jurisdiction of this action pursuant to §§ 407.100 RSMo., which provides; in part:

> (1) Whenever it appears to the attorney general that a person has engaged in, is engaging in or is about to engage in any method, act, use, practice or solicitation, or any combination thereof, declared to be unlawful by this chapter, the attorney general may seek and obtain, in an action in a circuit court, an injunction prohibiting such person from continuing such methods, acts, uses, practices, or solicitations, or any combination thereof, or engaging therein, or

doing anything in furtherance thereof.

(2) In any action under subsection 1 of this section, and pursuant to the provisions of the Missouri Rules of Civil Procedure, the attorney general may seek and obtain temporary restraining orders, preliminary injunctions, temporary receivers, and the sequestering of any funds or accounts if the court finds that funds or property may be hidden or removed from the state or that such orders or injunctions are otherwise necessary.

(3) If the court finds that the person had engaged in, is engaged in, or is about to engage in any method, act, use, practice or solicitations, or any combination thereof, declared to be unlawful by this chapter, it may make such orders or judgments as may be necessary to prevent such person from employing or continuing to employ, or to prevent the recurrence of, any prohibited methods, acts, uses, practices or solicitations, or any combination thereof, declared to be unlawful by this chapter.

(4) The court, in its discretion, may enter an order of restitution, payable to the state, as may be necessary to restore to any person who has suffered any ascertainable loss, including, but not limited to, any moneys or property, real or personal, which may have been acquired by means of any method, act, use, practice or solicitations, or any combination thereof, declared to be unlawful by this chapter. It shall be the duty of the attorney general to distribute such funds to those persons injured.

(5) The court may award to the state a civil penalty of not more than one thousand dollars per violation; except that, if the person who would be liable for such penalty shows, by a preponderance of the evidence, that a violation resulted from a bona fide error notwithstanding the maintenance or procedures reasonably adopted to avoid the error, no civil penalties shall be imposed.

(6) Any action under this section may be brought in the county in which the defendant resides, in which the violation alleged to have been committed occurred, or in which the defendant has his principal place of business.

6. Pursuant to Section 506.500 RSMo. provides that:

Any person or firm, whether or not a citizen or resident of this state, or any corporation, who in person or through any agent does any of the acts enumerated in this section, thereby submits such person, firm, or corporation, and, if an individual, his personal representative, to the jurisdiction of the courts of this state as to any cause of action arising from the from the doing of any such acts:

The transaction of any business within this state.

VENUE

7. Pursuant to § 407.100, venue is proper in the Circuit Court of the County of St. Louis, Missouri, because many of the alleged violations of § 407.020 against Defendant, occurred in the County of St. Louis, Missouri.

8. Pursuant to Section 506.500 RSMo. the Circuit Court of St. Louis County Missouri, has subject matter jurisdiction herein, due to Defendant having engaged in business within the State of Missouri.

STATEMENT OF FACTS

9. IFC helped to finance a large, fraudulent scheme by NorVergence, a reseller of telecommunications services. The victims of this fraud were small businesses, churches, non-profit organizations, governmental entities, and individuals who personally guaranteed the obligations of these organizations ("consumers"). The consumers agreed to price-guaranteed contracts for greatly discounted telecommunications services. The written contracts, however, concealed their predominant purpose - to finance services - because they were titled "Rental Agreements" and omitted any reference to the services that were being financed. This made it easier for finance companies to enforce the contracts even if the promises services were never delivered.

10. Acting pursuant to a complex contract with NorVergence, called the "Master Program Agreement", IFC's close relationship with NorVergence resulted in subsequent

purchases of consumers' NorVergence Rental Agreements. NorVergence told consumers that payment on the Rental Agreements would ensure all of the savings on telecommunications services that NorVergence had promised. IFC repeated that promise to its customers. The Master Program Agreement is attached hereto, marked as Exhibit 1, and incorporated herein by this reference.

11. In fact, none of these consumers received more than a small period of services, and many consumers never received any of the promised services. Nonetheless, IFC has demanded payment in full on the Rental Agreements. IFC falsely claims that, since a small piece of equipment, typically worth less than $1,500, was delivered to the consumers' premises, the consumers have no defenses to its demands for payment in full. IFC has enforced its payment demands by filing suits and executions of judgments in courts far distant from where the consumers are located. IFC has also collected various fees far in excess of what it was legally entitled to collect.

The Connection Between IFC and NorVergence

12. IFC's close connection to NorVergence began when it reviewed NorVergence's proposed operations and its marketing approach to consumers, including the five-year price guarantee on telecommunications services. Afterward, on or about October 10, 2003, IFC entered into a Master Program Agreement with NorVergence to provide financing for NorVergence's sales. IFC internally referred to the arrangement as the "IFC Credit/NorVergence Partnership."

13. Two agreements between IFC and NorVergence became especially important when NorVergence failed to provide promised services. First, the Master Agreement provided

that, in the event of a default on a consumer's first payment, IFC could require NorVergence to repurchase the Rental Agreement. Second, under the Master Agreement, IFC and NorVergence also agreed that consumers should be held liable for payment even if NorVergence failed to provide the promised telecommunications services.

14. These agreements indicated that, no later that early 2004, IFC learned that many consumers had not received promised services nor had NorVergence connected the consumer's equipment. In addition, IFC learned that NorVergence was secretly reimbursing consumers who would have otherwise refused to make their first of subsequent payments. Instead of exercising its remedies against NorVergence, under the Master Agreement, IFC chose not only to keep the Rental Agreements and seek its remedies against the victim consumers, but also to continue accepting new assignments of NorVergence Rental Agreements. This allowed the NorVergence fraud, and IFC's continued financing of it, to continue.

15. As further described below, IFC maintained its close relationship with NorVergence up to the filing of NorVergence's bankruptcy, despite ever-increasing reports of NorVergence's failures to provide promised services to consumers.

The Fraud that IFC Financed

16. NorVergence resold telecommunications services it purchased from common carriers or others. NorVergence marketed its services as integrated, long-term packages, including land-line and cellular telephone service, as well as Internet access.

17. NorVergence promised substantial savings to consumers. In fact, NorVergence priced its service packages without regard to its cost of providing the services and related equipment, which was likely to be much higher. NorVergence set the price at a discount, usually

30% less than what the consumer was currently paying for those services. It also typically promised unlimited minutes for both long-distance and cellular calls for a fixed charge, although NorVergence was obligated to pay its telecommunications service providers on a usage basis for the services it provided to consumers. NorVergence salespeople laid out the promised savings to prospective customers in writing, in the form of a "Cost Savings Proposal" so customers could see what they would be paying and savings on a monthly and annual basis.

18. In its earliest communications with consumers, IFC repeated NorVergence's claim that consumers would be guaranteed the promised service and savings for five (5) years. NorVergence also falsely represented that if anything happened to NorVergence, the consumer would continue to receive the services for they had contracted.

19. In its sales presentations, NorVergence represented that it could produce dramatic savings and free minutes through the installation of a "black box," with proprietary technology, on the customer's premises. NorVergence called the box, the "Matrix," an acronym for "Merged Access Transport Intelligent Xchange." The Matrix would supposedly route telecommunications in a manner to provide the promised savings. The Matrix came in two versions, the Matrix 850 and the Matrix SOHO.

20. The Matrix 850 is a standard "integrated access device," or "IAD" commonly used to connect telephone equipment to a long-distance provider's T-1 (high-band with data line) or similar date line. The Matrix 850 is wholly unrelated to a cellular phone access, nor does it significantly establish or change the costs of the long-distance service, if at all. The Matrix 850 cannot provide for unlimited minutes of telecommunications usage.

21. The Matrix SOHO, a smaller or similar device with reduced functions, is a

standard firewall/router used to access Internet services. This Matrix box does not provide access to telephone or cellular phone services.

22. On their own, the Matrix boxes could do nothing to create "free minutes" on land-lines and could not affect cellular services at all. NorVergence was still obligated to pay its own suppliers for the services it promised its customers. If it did not do so, the Matrix box alone had virtually no value. It was not directly compatible with other telecommunications service providers and, in any event, the finance company, such as IFC, owned the matrix. Thus, the consumer could neither alter, nor sell the device. Therefore, the receipt of services was contingent upon the continued viability of NorVergence.

23. NorVergence procured customers' signatures on a large set of documents, including a "Customer Qualifying Questionnaire," an "Accurate Bill Receipt and Proposal Request," a "Receipt of Savings Guarantee Subject to Mutual Due Diligence & Acceptance by Engineering," a "Credit Application," a "Letter of Agency," a "No-Risk Reservation Agreement," a "Hardware Application," all of which were represented to be "non-binding." The "non-binding" nature of the hardware and service applications were stated in bold-print capital letters at the top of the documents.

24. A document entitled "Equipment Rental Agreement" (or "Rental Agreement") was included with other documents that NorVergence had consumers sign. This was the contract NorVergence assigned to IFC. Salespeople simply included the Rental Agreement in the pile of documents, or told customers that they needed to sign it before the equipment was installed so they cold get the promised services.

25. The Rental Agreement listed a monthly payment to be made to NorVergence for

60 months or, rarely a shorter term. As noted above, the total payment was based on a 30% reduction of the consumer's costs for services. Most of the total price for services and equipment quoted to the consumer was allocated to the rental agreement. The contract, however, did not list the services to be provided, only listed the Matrix box and, occasionally, some related equipment. The remaining balance of the quoted price for services was allocated to the service applications and agreements, but it was only a small fraction of the rental amount and was unrelated to the actual costs of providing telecommunications services. In many cases, the owners of the small businesses or managers of the non-profit organizations were required to personally guarantee payment of the Rental Agreement.

26. NorVergence's contract with its principal supplier of the Matrix box established a price of $1,550 for the Matrix 850, although the actual price paid by NorVergence was less. NorVergence typically paid less than $350 for each Matrix SOHO it provided to its customers. NorVergence's cost could increase up to $462 if six extra "cards" (which increased the number of outgoing lines that the box could service), were installed. According to IFC records, only one contract assigned to IFC had as many as six cards, however, and fewer than 5% of the boxes in deals financed by IFC had as many as three cards.

27. Monthly billings under the Rental Agreements had nothing to do with these costs or value. Instead, they called for payments that, over the life of the contracts, dramatically exceeded NorVergence's cost for the Matrix and its fair market value. Most Rental Agreements required consumers to pay rent on the Matrix 850 ranging from a hundred dollars, to thousands of dollars, each month for 60 months. The total payments for "renting" the Matrix 850 varied, with gross disparities between various Rental Agreements.

28. The rental payments for the SOHO boxes varied. IFC also saw SOHO contracts with this variance in the first few weeks of its purchasing of NorVergence Rental Agreements. There were no “cards” associated with SOHO boxes to account for even a small portion of the variance in rental payments.

29. The Rental Agreements provided, on the back page and in small-print, that hardware and service applications were “non-binding,” and that they were not subject to cancellation for any reason. After obtaining the consumer’s signature on this agreement and the various, “non-binding” applications and forms, NorVergence sold or assigned the Rental Agreement to IFC, usually for the full five-year term, or occasionally for some part of that term. IFC paid NorVergence a discounted portion of the total rental price. For example, in one instance IFC paid NorVergence $49,000 for a Rental Agreement for a Matrix box with a single “card,” where the consumer’s total rental payments were nearly $65,000. In another instance, IFC paid $93,000 for Rental agreement calling for over $160,000 in consumer payments for a Matrix box with four “cards.”

The NorVergence Selling and IFC’s Response

30. After selling the Rental Agreements, NorVergence’s only ongoing income was the payments received from its customers, which were supposedly allocated for telecommunications services. That income was only a small fraction of the cost of providing these services. NorVergence did not reserve a sufficient amount of proceeds from the assignment of the Rental Agreements to pay for the telecommunications services it had promised consumers.

31. IFC continued to finance NorVergence’s fraud by accepting new assignments of NorVergence Rental Agreements, despite being made aware of NorVergence’s failure to provide

services and a high rate of default.

32. Rather than ceasing to accept new assignments of NorVergence Rental Agreements, IFC's response to evidence that consumers were not receiving the promised services was to change its Master Program Agreement with NorVergence, several times in rapid succession. Each change was designed to further limit IFC's financial losses due to the increasing customer defaults caused by NorVergence's failure to deliver the promised telecommunications services. Some changes were also designed to improve IFC's financial position in the event of NorVergence bankruptcy.

33. One such change IFC used to limit its losses due to customer defaults, was to reserve, and keep a percentage of the payoff it owed NorVergence for assignment of contracts. This "holdback" was initially 10% or less. As NorVergence declined and consumer problems mounted, IFC demanded holdbacks reaching at least 50% of the payoff price. By holding back this money, IFC also effectively doubled its projected rate of return on those contracts.

34. On June 16, 2005, two weeks before NorVergence's involuntary Chapter 11 filing, IFC and NorVergence entered into agreements that gave IFC over $15 million in new security based on Rental Agreements not yet assigned by NorVergence to any finance company. IFC paid nothing for this additional security. It was obvious after the bankruptcy filing that no consumers who were party to these contracts would ever receive any of the promised services. Nevertheless, IFC sought relief from stay from the bankruptcy court to take possession of these Rental Agreements so it could begin collections. After the FTC and several other parties filed objections, IFC withdrew its petition for relief from stay. The NorVergence Judgment determined that those unassigned Rental Agreements were void and unenforceable.

35. IFC has continued to insist on payment of the full balance remaining on NorVergence Rental Agreements, based on an acceleration clause. In some lawsuits, IFC has discounted this payment stream to a present value but added interest back in. In other suits, IFC has claimed that it was damaged in the amount of its payoff to NorVergence. However, in some or all of these suits, IFC claimed under oath that it had paid the full payoff amount, while it had actually paid thousands of dollars less because of the holdback amount it kept as a reserve against losses, as described in paragraph 33.

36. Many consumers believed, based on later representations by IFC, that they had no recourse because the payments called for by the Rental Agreements were only rental payments for the Matrix, pursuant to the written Rental Agreements, and not payment for services as described by NorVergence. Paying for up to five years of un-received phone services places a severe financial burden on many consumers, all of whom have to pay, additionally, for actual phone services to maintain their businesses or organizations. They also had to pay the costs of changing their telecommunications systems twice, first to NorVergence and then to replacement carriers.

IFC Knew or Consciously Avoided Knowing that NorVergence was Likely Engaged in Deceptive Acts or Practices

37. IFC knew or consciously avoided knowing that NorVergence was likely engaged in deceptive acts or practices, based on its knowledge that the NorVergence Rental Agreements predominately financed services, and was not an equipment lease or rental. It obtained this knowledge, or the basis for this knowledge, from the Rental Agreements it received, and from its financing partnership with NorVergence Compliance with provisions of the Rental Agreements. Applicable laws should also have resulted in this knowledge, as would the widely varying

contract prices and continuing consumer complaints.

38. Even before IFC purchased Rental Agreements from NorVergence, NorVergence made it clear to IFC that it was mainly selling to consumers, a savings package on their telecommunications services. IFC was aware of the NorVergence sales presentations, which heavily emphasized to consumers the savings on telecommunications that NorVergence could provide. For example, a NorVergence PowerPoint for potential financiers, demonstrated the "cost savings strategy" it would use to attract customers. It compared the consumer's current monthly expenditures to a lower new payment for the combination or renting the Matrix box and telecommunications access.

39. IFC's knowledge that the represented cost savings were guaranteed for five years, and that the payments on the Rental Agreements were for telecommunications services, is also demonstrated by a "Confirmation Script" that IFC used for calling consumers before accepting assignment of their Rental Agreements. IFC employees using this script, reminded the consumer of the amount of the monthly rental payment and stated that this "flat monthly cost is protected for a 60-month term, producing the NorVergence savings you were promised." The promised 5-year savings could only result if NorVergence provided the promised telecommunications services.

40. NorVergence never offered to sell Matrix boxes and never quoted a sales price to consumers. As NorVergence explained to IFC when demonstrating its business plan: "We do not sell, we require the customer to submit an application for cost savings solution."

41. IFC knew the contents of the NorVergence Rental Agreements before they were executed by NorVergence customers. They could see that these were not typical equipment

leases because NorVergence contracts with consumers differed significantly from IFC's normal form contracts. For example, IFC's typical equipment leases contain language stating an unequivocal intent to be governed by Uniform Commercial Code, Article 2A ("UCC Art. 2A"). This is presumably because some provisions of UCC Art. 2A are significantly more favorable to creditors than they laws relating to non-lease finance contracts or service agreements.

42. NorVergence Rental Agreements did not state an unequivocal intent to be covered by UCC Art. 2A, apparently because UCC Art. 2A applies only to bona fide equipment lease financing. It does not apply to the financing of services, the predominant purpose of the IFC financing of NorVergence. The NorVergence Rental Agreements refer only to a possibility that some future interpretation might determine that UCC Art. 2A applied to the agreement:

> 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.

43. It was clear, however, that these were not "finance leases" as defined by Article 2A for various reasons. Among others, Section 2A-103(1)(g) requires that the "lessor [rentor] does not select, manufacture, or supply the goods." Here, the original "rentor," NorVergence, selected and supplied the Matrix box, as well as the telecommunications services. Therefore, Article 2A would not apply.

44. Second, IFC would have had to *determine the Matrix* Box replacement cost to determine *the* amount of insurance coverage for loss, and should have done so in order to decide how much insurance consumers should be required to carry pursuant to the Rental Agreements. These agreements provided that the consumer must carry loss and damage insurance on the Matrix box or, in the alter native, that it could obtain that insurance and pass the cost of

premiums on the consumer ("force placed insurance'). However, IFC based its insurance demands on the full amount it paid, or was obligated to pay, NorVergence for the Rental Agreement. Had IFC duly ascertained the cost to replace the Matrix box, it would have known that the rental amounts bore no relationship to the value of the Matrix supposedly rented. In addition, IFC's payoff amount to NorVergence could vary depending on the consumer's credit rating. That credit rating could not have affected the cost to replace the Matrix box.

45. As a result of IFC's demanding insurance coverage based on the payoff amount to NorVergence, consumers were paying premiums for loss and damage coverage based on an amount that was many times higher than the amount of coverage that IFC was entitled to require. The consumer's opportunity to learn of this deception was extremely limited because the policies were in IFC's name and for IFC's benefit. Because the consumer was not the insured party, he or she could not make any inquiry of the insurance company regarding the policy, coverage, or actual premium amounts.

46. Third, in order to determine an appropriate amount of business personal property tax to collect in the many jurisdictions where this applied, IFC should have determined the actual value of the Matrix box. These taxes are typically due on the fair value of the business equipment, with depreciation sometimes taken into account. Therefore, IFC consciously avoided knowing that the rental amounts bore no relationship to the value of the Matrix supposedly rented. While IFC may only have collected property taxes on a few occasions, in the affected state(s), it collected many times the amount of property taxes actually due.

47. In sum, when IFC decided to do business with NorVergence, IFC knew or consciously avoided knowing that NorVergence was primarily selling a discounted package of

telecommunications services, that it promised those services would continue for five (5) years, and that the Matrix box was an incidental part of the promised services, Subsequently, when accenting widely varying rental payments for the same equipment, or analyzing the value of the equipment for accounting, tax, or insurance purposes, IFC knew or consciously avoided knowing that the Matrix box was worth only a very small fraction of the rental price and that the Rental Agreements misstated the predominant purposing of the financing by falsely stating that the consideration for the agreements was only a Matrix box. In addition, IFC continued to accept new NorVergence Rental Agreements after numerous customers had told it that they were not receiving the promised services. Based on these facts, it knew or consciously avoided knowing that the NorVergence Rental Agreements were likely part of a scheme to defraud consumers through deceptive practices.

Deceptive Rental Agreement Language

48. In addition to falsely stating that the rental payments were only for a Matrix box, several contractual provisions in the NorVergence Rental Agreements allowed IFC to misrepresent consumers' rights and obligations. The NorVergence Rental Agreements included various provisions that appeared to allow it to enforce them in the event of a NorVergence default, or created an ambiguity regarding IFC's ability to enforce.

49. Among the provisions that IFC claims prevent consumers from ever raising any defenses are the Rental Agreement's "Assignment" provisions, which appear in tiny type on the back of the agreement:

> ASSIGNMENT:
>
> YOU MAY NOT SELL, PLEDGE, TRANSFER, ASSIGN OR SUBRENT THE EQUIPMENT OR THIS RENTAL. We may sell, assign or transfer all or any part

> of this Rental and/or the Equipment without notifying you. The new owner will have the same rights that we have, but not our obligations. You agree you will not assert against the new owner any claims, defenses or setoffs that you may have against us.
>
> YOU UNDERSTAND THAT ASSIGNEE IS A SEPARATE AND INDEPENDENT COMPANY FROM RENT OR/MANUFACTURER AND THAT NEITHER WE NOR ANY OTHER PERSON IS THE ASSIGNEE'S AGENT. YOU AGREE THAT NO REPRESENTATION, GUARANTEE OR WARRANTY BY THE RENTOR OR ANY OTHER PERSON IS BINDING ON ANY ASSIGNEE, AND NO BREACH BY RENTOR OR ANY OTHER PERSON WILL EXCUSE YOUR OBLIGATION TO ANY ASSIGNEE.

50. Another tiny-type provision on the back of the agreement that IFC now relies on purported to waive all defenses against the original "Rentor," which was NorVergence, while preserving claims against the "manufacturer or supplier," which was also NorVergence:

> YOUR DUTY TO MAKE THE RENTAL PAYMENTS IS UNCONDITIONAL DESPITE EQUIPMENT FAILURE, DAMAGE, LOSS OR ANY OTHER PROBLEM. . . . if the equipment does not work as represented by the manufacturer or supplier or any other person fails to provide service or maintenance, or if the Equipment is unsatisfactory for any other reason, you will make any such claim solely against the manufacturer or supplier or other person and will make no claim against us.

51. This confusing provision creates the false impression that the consumer's duty to pay would survive a complete failure in consideration. This and the assignment provisions, among others, have been used by IFC to support its misleading claims that consumers had no defenses to IFC demands for payment in full, regardless of any fraud or deception perpetrated by NorVergence or participated in by IFC

52. IFC also used the NorVergence Rental Agreement's ambiguous reference to a purported possibility that UCC Art. 2A might apply to mislead consumers about their ability to raise defenses (see paragraphs 42 through 43 above). IFC misrepresents that consumers have automatically waived defenses by application of UCC Art. 2A, since lessees under UCC Art. 2A

"finance leases" have fewer rights than other lessees or renters,

53. IFC was in a much better position than consumers to understand that the ambiguous UCC Art. 2A paragraph could not render the contract an Article 2A finance lease. It was also in a much better position to understand that other ambiguities or false statements in the Rental Agreements could give rise to consumers' defenses against IFC indeed, a May 2004 internal circulation included the following comment made by IFC's general counsel:

> [To] the extent that the Customer has not received any consideration in the form of working equipment in exchange for the rental payments due under the contract - we may be hard pressed to show how we have a valid and enforceable contract and some of these unfair business statutes provide for treble damages and attorneys fees if we lose.

Deceptive Claims Regarding Other Theories of Consumers' Liability to IFC

54. IFC regularly claimed in debt collection letters and elsewhere that consumers could be liable to IFC for "Fraud in the Inducement" and "Misrepresentation," and for intentionally deceiving IFC into paying NorVergence for the Rental Agreements. These claims were supposedly based on oral and written acknowledgments from consumers that Matrix boxes had been delivered, shortly after each consumer signed the NorVergence Rental Agreement, the Matrix box was delivered to the business premises. Within a few days or weeks after that, IFC obtained from the consumer a signature to a boilerplate acceptance form. The form recited that the consumer "has received and accepted all the Equipment described in the New Rental Agreement" and that the "Equipment conforms with our requirements." The form also provides that the consumer agrees that the rental payment will begin in sixty (60) days, but says nothing further about the equipment, including whether it is operational. The acceptance form for the

Matrix box was markedly different from IFC's standard acceptance form for equipment financing. In its standard form, the consumer acknowledges that the equipment is "in good order and condition," in other words, that it was working, something the consumer could not possibly know for months regarding the sources anticipated with the Rental Agreement.

55. Thirty-Nine (39) Missouri consumers and businesses entered into contracts with the Defendants and/or prepaid full or partial payment for telecommunications services and have filed Complaints with the Office of Missouri Attorney General.

56. Defendants have not provided or have refused to provide refunds to these Missouri consumers and businesses.

57. Other Missouri consumers and businesses have contracted with and paid the Defendant for NorVergence services, and did not receive the contracted services as promised by NorVergence.

MERCHANDISING PRACTICES ACT VIOLATIONS

58. Plaintiff hereby incorporates by reference all of the allegations contained in paragraphs 1 through 57 above as fully set forth therein.

59. Defendant IFC has engaged in methods, acts, uses and practices of deception, fraud, false pretenses, false promise, misrepresentation, unfair practice, and the concealment, suppression and omission of material facts in connection with the sale of goods and services in Missouri, all in violation of § 407.020, RSMo.

RELIEF

WHEREFORE, Plaintiff requests this Court to issue the following Orders:

1. An Order of this Court finding Defendant has violated the provisions of §

407.020, RSMo.

2. A preliminary and permanent injunction issued pursuant to § 407.100, prohibiting and enjoining Defendant and their agents, servants, employers, representatives, and other individuals acting at their direction or on their behalf from violating § 407.020, through the use of any of the unlawful, unfair and deceptive acts and practices alleged herein.

3. An Order of this Court requiring Defendant to provide full restitution, reformation or rescission of contracts, and cancellation of purposed debts, to all consumers from whom Defendant has received monies who have been aggrieved by the use of any unlawful, unfair and deceptive acts and practices alleged herein.

4. An Order of this Court awarding the State a civil penalty from Defendant of One Thousand Dollars ($1,000.00) per violation of § 407.020, that the Court finds to have occurred.

5. An Order of this Court ordering Defendant to pay to the State an amount of money equal to ten percent (10%) of the total restitution ordered against said Defendant, or such other amount as the Court deems fair and equitable.

6. An Order of the Court requiring the Defendant to pay all Court and investigative and prosecution costs of this case.

7. Such other or additional relief as the Court deems necessary in this action.

Respectfully submitted,

JEREMIAH W. (JAY) NIXON
Attorney General

____

Respectfully submitted,

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