Commercial Equipment Leasing and a Discussion of Norvergence Related Actions

Robert Radasevich

Bonnie Michael

Follow this and additional works at: https://via.library.depaul.edu/bclj

Recommended Citation
Available at: https://via.library.depaul.edu/bclj/vol3/iss4/7
Commercial Equipment Leasing and a Discussion of Norvergence Related Actions*

Robert Radasevich and Bonnie Michael

MARK LEIPOLD: The next area that we’re going to be talking about is the panel that we’ve assembled for Norvergence. So instead of discussing what happened, we’ll talk about what’s happening now or what might happen.

Today we have with us today Bonnie Michael and Rudy Radasevich from Neal, Gerber & Eisenberg, LLP.

Bonnie and Rudy are both in the bankruptcy reorganization and creditor’s rights group at Neal, Gerber & Eisenberg. Rudy represents trustees, creditors, committees, and individual creditors involved in business-related bankruptcy issues. He has litigated complex commercial cases and is well known and well respected in the Chicago bankruptcy community. He received his undergraduate degree from Southern Illinois University and is a graduate of DePaul University College of Law, where he served as Note and Comment Editor of the Law Review.

Bonnie has significant experience in litigation and bankruptcy matters, as well, and she is also an active member in the Equipment Leasing Association and a contributor to ELA’s online leasing law library. Ms. Michael graduated from Chicago-Kent College of Law, and received her Bachelor of Arts in 1983 from the University of Wisconsin at Madison.

It is my pleasure to introduce them to talk about Norvergence and issues that lawyers like us are facing on a day-to-day basis today.

ROBERT RADASEVICH: Thank you.

We’re going to sit down so we can kind of banter between each other, make it a little bit easier. I know it’s kind of late in the day. Especially after lunch, I want to take a little snooze. And since I feel like I’m at my church where nobody wants to sit in the front row, we are going to move this along a little bit, and try to get back on schedule.

* This is an edited version of the transcript from the fourth panel at the DePaul Business AND COMMERCIAL LAW JOURNAL SYMPOSIUM, Out with the Old, In with the New? Articles 2 and 2A of the Uniform Commercial Code, held on April 7, 2005.
If there's any participation from the audience, just raise your hand or bark out a comment. We're going to try to talk about things that we, as commercial attorneys, do on a daily basis. Bonnie's the lead. I'm here for comic relief, so I'll hand off.

BONNIE MICHAEL: He keeps saying that, but I don't believe him.

Before we get into the heaviness of Norvergance and Article 2A, I want to share with you a couple of stories that I have from growing up. Now, I imagine that a lot of you grew up in the Midwest, and Rudy and I both grew up in the Midwest. In fact, I grew up in the dairy state.

Now, the first item I want to share with you is cow tipping. It's a form of entertainment, and I imagine that some of you, being from the Midwest, know what cow tipping is. Essentially, it is generally a form of entertainment for, I hope, the younger set. An individual or a group of teenagers will sneak into a field at night and look for an unsuspecting cow sleeping while standing up. And I know it seems strange that cows sleep while standing up, but I understand it's true. And they thrust their total weight into the cow to tip it over, and then run like heck to get away, just in case the cow is not so thrilled with their shenanigans.

ROBERT RADASEVICH: Copious amounts of alcohol all around, presumably.

We have a comment.

AUDIENCE MEMBER: Excuse me. Could you turn your microphone towards your lips? Thank you.

BONNIE MICHAEL: Is this better?

Now, I can honestly tell you that I have never been involved in a cow tipping incident. I can't speak for any others in this room.

The second item that I want to share with you is a dairy land parable, the cow in the ditch. Now, the cow in the ditch goes something like this. What do you do when you find out that your cow's gotten stuck in the ditch? Well, first, you figure out how to get the cow out of the ditch. Second, you find out how the cow got stuck in the ditch in the first place. And, third, you do whatever it takes to make sure that that cow never gets stuck in the ditch again.

Now, I would suggest to you that the cow in the ditch principles are much more useful than the cow tipping that I just shared with you, and I hope that by the end of this speech you'll walk away saying, you know, I really want to use those cow in the ditch principles instead of
looking for that unsuspecting cow at night because I’m told that tipping can not only injure the cow, but it’s a felony in some states.

Now, today we’re going to use the cow in the ditch principles to discuss a current problem that the equipment leasing industry is facing related to Norvergance. It’s a $200 million problem.

Let me give you a little bit of background for those of you that aren’t familiar with Norvergance as to how this Norvergance episode started out — essentially, how the cow got stuck in the ditch. We’ll discuss how the case law treats some of the more significant issues involved, and hopefully we’ll give some options for getting the cow out of the ditch. Finally, we will discuss how to possibly prevent future Norvergance-like dilemmas, so that this $200 million cow doesn’t ever get stuck in the ditch again.

Now I’m feeling a little bit of guilt because I can’t claim that I truly learned the cow in the ditch principle as a youth in Wisconsin, but I did read it in Fortune Magazine about a month ago.

Now that we’ve cleared that up, we can go on and talk about Norvergance. Now, we thought about this speech and we were tossing around ideas about sharing Ohio and Texas cases where the court looked at whether transactions were true leases or disguised security interests. We looked at the Sixth Circuit decision holding that Tennessee law doesn’t require a lessor to notify a lessee when disposing of leased goods after a default. But instead we thought we would talk a little bit about Norvergance. I think it’s a little bit bigger, a little bit sexier. We’re talking about alleged fraud, and so, hopefully, this will be a little more interesting than what’s happening in the smaller cases.

ROBERT RADASEVICH: I can go farther. I think Norvergance, just what’s going on in that case, could be an entire seminar course that Professor Livingston could teach at DePaul. There are so many different things going on, from business torts, to choice of venue provisions, to civil procedure issues, and bankruptcy issues. Tons of different issues come out of that case, and they are likely going to cost the commercial leasing company industry a lot more than the $200 million that was paid to Norvergance for assignments and security interests in its leases. It’s a whole world of hurt. It’s a toxic ditch. There are actions all over the country by different attorney generals that we’ll talk about in a little bit, both going after Norvergance and going after finance companies who they claim are in bed with Norvergance and are guilty of Rico violations, which is something that all plaintiff lawyers love to hear because they see dollar signs in their eyes.

BONNIE MICHAEL: And I know you wanted to do a caveat about how we will —
ROBERT RADASEVICH: Oh, right.

Everything in Norvergance is still in the pleading stage. There are a lot of cases going on. A lot of allegations can and have been made. So we are like the reporters on the 6:00 news. They report about a murder, and even though the cops caught the guy with a gun in his hand, they still call him "the alleged murderer." So everything we say about the facts dealing with Norvergance are alleged facts. Just assume we say "alleged" every time we describe the facts in Norvergance. It is like when I go fishing in Canada. I tell my guide, "Just pretend I say please and thank you before I ask you to do anything and when you get done. I really mean it. I really mean to say please and thank you, but I never will. So just pretend we are saying alleged all the time because we never will.

I also call Norvergance NorVENGEANCE because I like that better, but it is really Norvergance.

BONNIE MICHAEL: Okay. A little bit of background about Norvergance.

Norvergance was a company that provided discount telecommunications services. Norvergance would contact potential business customers and tell them that they could wrap up all of their internet, local and long-distance telephones, and cell phone services into one very low priced, unlimited-in-use package.

How they did this was Norvergance bundled up, in part, a service agreement which had very low monthly rates, and then they sold their customers, what they called, the matrix. The matrix is essentially a router box. Norvergance told prospective customers that everything was going to go in and out of that magic matrix box, which was what allowed them to have the unlimited access and made the services very inexpensive.

Norvergance leased the matrix boxes directly to their customers. The matrix box, from what we have researched or what we have read, had an actual retail price of somewhere between $500 and maybe $1,500, $2,000, $2,500, at most.

ROBERT RADASEVICH: Now, Norvergance also told its customers, who were all small- to medium-sized businesses, schools, churches, and other type of small relatively unsophisticated businesses that did not have their own in-house counsel, that "the matrix box was the elixir of the telecommunications world. It will do everything. It is our proprietary technology you have got to get from us. You cannot buy it from us. You have got to lease it from us."

BONNIE MICHAEL: We gave you copies of a Norvergance lease. We gave you an actual copy of a lease that someone else had been
kind enough to remove identifiers from, and then we gave you, what I call the easy-read version, which is three pages long.

Norvergance leases were set up for sixty-month terms. That seems like a long term for something that has a value of, say, $500 to $1,500. Well, the monthly lease payments on these leases ran from a couple hundred dollars a month to $2,500 a month.

ROBERT RADASEVICH: Now, the way Norvergance determined monthly lease payments for its customers had nothing whatsoever to do with the price Norvergance paid for the matrix boxes when it bought them from third party vendors. Instead, Norvergance contended that it had to do with the anticipated savings that the customer was going to realize because of this magical matrix box. Norvergance told its customers that they would be able to chop huge amounts of costs out of their internet and phone service bills.

Norvergance would take a percentage of that anticipated savings and telling its customers "you are going to pay us X percent of that savings per month for sixty months. At the end of sixty months, you will own this box. If we go out of business, it is not a problem. We are in tight with Quest. We are in tight with Sprint. This matrix box and our service will still work even if we, Norvergance, are no longer in business." And that is how they came to these tremendous differences between what Norvergance paid for the matrix boxes and what they charged their customers under 60 month leases for the lease of the boxes.

So over sixty months, Norvergance customers were paying anywhere from $12,000 to $90,000 or $100,000 for a box that they could purchase on the street commercially for around $1,500.

BONNIE MICHAEL: There were about eleven thousand of these lease transactions entered into in numerous different states. The leases total about $230 million, and assignees paid an estimated $200 million for assignments or security interests in the Norvergance leases.

In June of 2004, Norvergance was forced into bankruptcy by its creditors.

ROBERT RADASEVICH: Norvergance, like a lot of different companies that lease their products, had a series of about 26 different finance companies that would purchase or take security interests in Norvergance's leases. Norvergance had all of its financing sources all set up. It would sign on Betty's Beauty Parlor and then immediately go to one of its financing sources and essentially sell the lease at a discount off of the present cash value of the income stream. So Norvergance would get the bulk of its money up front.
Norvergance had to pay for the telecommunication services it purchased from Quest or Sprint, and then turned around and dished those services out to its customers. Well, even the $200 million Norvergance received from its financing companies wasn’t enough to keep the telecommunications companies happy. Norvergance became delinquent and the telecommunication companies started turning off service. Then a group of Norvergance’s financing companies joined together and put it into an involuntary bankruptcy.

Norvergance simply ran out of cash. It appeared to be, as some of the lawyers alleged, a Ponzi scheme. Norvergance signed up new customers and used their resources to pay for telecommunications services for the people who were first on the block. But as more and more people signed up, as eleven thousand people signed up, Norvergance ran out of cash to keep its engine going, and it was forced into bankruptcy. It was forced into bankruptcy on June 30th. By July 14th, it was converted to Chapter 7.

BONNIE MICHAEL: Not too long after that a class action suit was filed against Norvergance and about 26 of the assignees.

The class action suit is in its third round of drafting. It has been in state court. It went up to Federal Court and then was sent back down to state court. Initially, it alleged consumer fraud, illegality, fraud, and contract formation. Also, it sought a declaratory judgment against the assignees and prayed for a range of relief including returning all funds paid, actual damages, and injunction against future performance. They also had initially sought to enjoin all of the assignees from filing suit in the location that was the assignees’ principal place of business. The court, however, did deny that initial relief.

ROBERT RADASEVICH: In addition to that class action suit, once Norvergance filed bankruptcy, all hell broke loose for this company. There have been a host of consumer complaints all around the eastern part of the United States, including suits brought by various state attorneys generals and different state regulatory agencies. Customers weren’t getting their services. They couldn’t return the boxes. They were getting sued by the leasing companies or by the finance companies to compel payments under the Norvergance leases. So state attorneys generals in Illinois, Pennsylvania, Massachusetts, North Carolina, New Jersey as well as the Federal Trade Commission, filed suits against Norvergance to enjoin it from any conduct like this in the future, to stop them from ever doing business in their states again, and to seek recoupment of all the losses that had been sustained by any customers.
Now, all of those cases were originally just against Norvergance. Well, Norvergance’s bankruptcy proceeding has been converted to Chapter 7, and there’s nothing there for anybody. Everybody knows that. So then the attorneys generals started saying, “well, what about these lenders? What about these finance companies? They had to know what was going on here. They couldn’t have been financing over ten thousand of these leases without knowing what was going on.”

So, the attorney general down in Florida filed one case, and they named every finance company that had done any business with Norvergance anywhere in the state of Florida. And all of the other states attorneys generals filed suits as well. These suits all have the same type of claims in them. They’re all based upon their respective state’s consumer fraud statute.

Now, the definition of “consumer” in new U.C.C. Article 2A, (which Illinois will never adopt, as far as I can tell) limits “consumer” to an individual who buys something for a personal use, for a household use.

Most states, and Illinois is one, don’t currently limit their consumer fraud statutes in that fashion. A consumer is any entity who buys a product or a service, or leases a product or a service for its own consumption and not for resale.1 So, for example, a business that leases a computer system or leases a phone system is a consumer. Even if that business is Boeing, it is still a consumer under consumer fraud statutes.

If businesses lease products or purchase products for use by their customers, then they are not consumers. I represented a vendor of setup boxes used by customers of cable companies. Our client was being sued by a small cable operator who brought consumer fraud claims alleging that the set top boxes did not work as promised. Well, the cable operator didn’t use those boxes in their own personal business; they leased them to their customers, and so the consumer fraud statute didn’t apply.

But as long as a business uses product in its own business, the consumer fraud acts apply. Consumer fraud acts are extremely broad in their reach and their protection of consumers. Attorneys generals, many of whom are elected, love to enforce those bad boys. Plus, state attorneys generals belong to the same originations. If you look at the various complaints, they look a lot alike. The one out of Massachussetts and the one out of North Carolina are almost verbatim, like they

1. 810 ILL. COMP. STAT. § 5/2A-103 (2005).
came out of almost the same word processor. They all seek the same type of relief. They seek to enjoin the conduct. They seek to get restitution.

In the Florida suit, the Florida Attorney General goes after the leasing companies and the finance companies by essentially saying, "You had to know. You had to know that there was something wrong here."

We're going to talk about why certain provisions that we normally see in Article 2A litigation don't necessarily help the finance companies here. And then we'll circle back a little bit to the allegations that the Florida Attorney General is making and also that the New Jersey Attorney General was making in an adversary complaint that they've filed in the Norvergance bankruptcy.

BONNIE MICHAEL: Some of the key questions that come up in all of these cases, but especially in the class actions, are whether the choice of venues clauses in the leases are enforceable, whether the hell or high water clauses are enforceable by the assignees, and whether the waiver of defenses contained in the leases not to assert claims or defenses against assignees are enforceable. We're going to spend a substantial portion of this afternoon talking about those items.

First, we'll talk about the venue clauses. As we discussed, there have been actions brought by the assignees against the customers and the lessees in many different states, and some of these cases have been fought based on the venue clauses.

We should take a look at the venue clause, and we'll look at the easy reading portion.

ROBERT RADASEVICH: It's on the bottom of page two on the right-hand side where it says "applicable law."

BONNIE MICHAEL: And it essentially provides that venue is proper in either the renter or an assignees' principal place of business.

At least four courts have considered the venue clause. In Illinois, the Northern District of Illinois has considered the venue clause twice in *IFC Credit Corp. v. Aliano Bros. General Contractors, Inc.*, Judge Derra did not enforce this clause because he said it failed to identify a specific state and violated public policy requiring specificity in the forum selection clause.

In another Northern District of Illinois case, the judge used that same legal principle but noted that aside from the fortuitous fact that the lease was assigned to IFC, the litigation had no connection to Illi-

Consequently, the court transferred the matter in the interest of justice and the convenience of the witnesses to the forum of the original lessee.

The Minnesota district court has also looked at this venue clause. In Lyon Financial Serv. v. Will. H. Hall & Son Builders, Inc., the court rejected the argument that the forum selection clause was unenforceable because the lease was a product of fraud. It stated that a choice of venue was only unenforceable if inclusion of that clause was a product of fraud or coercion.

The court in Minnesota also rejected arguments that just because the clause was floating, meaning that it went from one jurisdiction to another, it was unenforceable. The court focused on the fact that only one forum was proper at any given time.

In a Pennsylvania case, the clause was also enforced. Here, the court applied what it perceived to be the U.S. Supreme Court’s standard in M/S Bremen v. Zapata Off-Shore Co., of not enforcing only if the clause was unreasonable under the circumstances. The Court rejected the lessee’s arguments based upon no specific forum identified and suggested that in these circumstances it was incumbent upon the lessee to make an inquiry to ascertain the identity of the assignee, or it would be bound by those terms.

ROBERT RADASEVICH: Now, that’s kind of crazy. To say that in a situation like this, where Norvergance is using twenty-six different finance companies, Betty’s Beauty Shop should ask them which one they’re going to sell her paper to so she’ll know where she may be forced to litigate is kind of crazy.

The difficulty you have with choice of venue and forum selection provisions is that there’s not a heck of a lot of developed case law. Most venue issues never get appealed because they’re not immediately appealable, and by the time a case gets upstairs on appeal, there’s usually a lot of other things going on and the venue issues often are not reached.

---

4. Id. at *4.
6. Id. at *3.
7. Id.
9. 407 U.S. 1, 10 (1972).
10. Id. at 17.
11. Id.
But if you think about it, the venue selection provision in Norvergence cases really don't select a venue at all. The choice of venue provision is not put in the lease for any business purposes vis a vis the lessor and the lessee. It's put in the lease to allow the lessor to be able to sell the lease to a finance company. It has nothing to do with the lessor, the ultimate consumer. I think if an Appellate Court actually did take a look at the forum selection clause in a Norvergence lease, they might very well find it to be unenforceable.

The arguments that have been made to the bankruptcy court where there are about forty-six pending adversaries, most against Norvergence and more than half against the finance companies, is that the choice of venue provision is also unconscionable under Section 108 of Article 2A.\textsuperscript{12} Section 108 of Article 2A says that if there's a provision in the lease which is unconscionable, the Court can either decide not to enforce the lease at all, or it can carve out that provision and force the balance of the lease.\textsuperscript{13} The lessees have argued that given what happened in this lease and under these circumstances, the choice of law provision is unconscionable and can't be enforced. And I don't think it shouldn’t be enforced, in my opinion.

BONNIE MICHAEL: Take a look now at the hell or high water provisions in this lease and the assignment provisions. They're, more or less, also typical.

ROBERT RADASEVICH: Hold on. Before we pass on that provision, it's also important to note that even if you have a forum selection provision, it doesn't mean you're going to be litigating in Puerto Rico if they happen to sell the paper to Banco Popular. That is essentially what happened in the second Illinois case.

Courts and federal courts in particular, will look to the interest of justice and the convenience of the parties in determining whether to keep a case in the venue where it's filed. And if the third party witnesses and evidence and the situs of the activity are in a jurisdiction foreign to the one that the choice of venue clause selects, you've got a good chance, particularly in Illinois, of getting out of that jurisdiction and getting back to where the situs of the activity truly is. So, choice of venue provisions can be a little bit misleading.

BONNIE MICHAEL: Okay. Now moving on to the hell or high water clauses and the assignment.

The assignment is on page three, and, as I said, it's very typical. It's in just about every lease:

\textsuperscript{13} Id.
You may not sub, pledge, transfer, sign, 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 none of our obligations, and you agree not to look against the new owner for any claims, defenses or setoffs that you may have against us.

It looks pretty good, and the lease goes on even a step further — and I won’t read this whole section to you — at the very, very end of the lease on the right-hand column to reiterate some of those ideas.

The hell or high water clause is typical. It has “no warranties, you absolutely must make payment” language. So it’s a very typical hell or high water clause as far as that goes.

Historically, hell or high water provisions and waiver of defense provisions have been enforced despite equipment issues and delivery of services. In *Leasetec Corp. v. Orient Sys., Inc.*,\(^{14}\) the hell or high water clause was enforced even when the equipment was not delivered, and the value of the equipment was not what the lease payments totaled or there was no apparent relationship.\(^{15}\) In *GreatAmerica Leasing Corp. v. Star Photo Lab, Inc.*,\(^{16}\) the Iowa Appellate Court enforced the hell or high water provision, despite a lessee’s dissatisfaction and claim that the product didn’t work from the very start, where the lessee verbally confirmed that the assignee had received and accepted the equipment.\(^{17}\) There are cases in Ohio where lessees of ATMs were still obligated under the hell or high water provisions in their leases to continue to make lease payments even though the company that had leased the ATM and was to provide related services went bankrupt and no longer provided any services. So, hell or high water clauses have historically been enforced.

ROBERT RADASEVICH: So what are the litigants claiming here? How are they trying to get out from underneath the weight of hell or high water provisions that are generally enforceable? And in the Norvergance lease, there’s even a provision saying this is a finance lease. Interesting concept. It says this is a finance lease, and if it’s a finance lease, there are other protections under the Code with built in, so to speak, hell or high water provisions which would benefit the assignee.

The Norvergance lease may be a lot of things, but a finance lease it ain’t. In order to be a finance lease, there are certain provisions of the

---

15. *Id.* at 1315.
17. *Id.* at 504-505.
Code that must be met. This lease meets none of them. The statement that the Norvergance lease is a “financing lease” is the type of overbearing statement which leads attorneys generals in some of the other states to say, “Finance companies, you had to know. You had to know. You’re in the business. Betty’s Beauty Parlor isn’t in the business. You’re in the business. You had to know these weren’t finance leases. But by calling them finance leases, you tried to wrap yourself with a blanket of other rights you have under U.C.C. Article 2A that you wouldn’t ordinarily have.”

So, what are the litigants saying? One of the things they’re saying is, “You know what, it’s not even a lease.” That’s what the private litigants are saying. It’s not even a lease. If you look at section 1-203, one of the things that it says is that an agreement may not be a lease if the lessee pays full price for the product, if the lease is noncancelable, if the lessee has a commitment to pay and is going to pay more than the product is worth. Under those circumstances, the agreement may be a financing arrangement, but it is not a true lease.

With respect to the Norvergance lease, if you recall the comments that were made just previously, there is no equipment of any residual value at the end of the lease that Norvergance could take back. They’re being paid fifty or one hundred times what the leased matrix box is actually worth. There is no economic reality at the end of this lease that Norvergance could step into. There is no lease. And that’s what the litigants in the class action cases are saying, that there is no lease. If there is no lease, then we don’t have to worry about the provisions of Article 2A at all because they don’t apply.

What the state attorneys generals are also arguing is that, given what they refer to as the rampant fraud engaged in by Norvergance in making all these blatant misrepresentations to consumers, enforcement of the hell or high water provision would be unconscionable. What that provision allows Norvergance to do is to lie its head off to its customers, sell the leases to finance companies, get paid eighty percent of the value of that income stream and then insulate the finance companies from any claims based upon Norvergance’s fraud. Customers would be barred from raising legitimate defenses against the financing companies and would be deprived of the right to sue anybody. That’s why they claim the hell or high water provision is unconscionable. If it’s unconscionable, it doesn’t apply.

BONNIE MICHAEL: Okay. They’re claiming that these leases are unconscionable, and if they are deemed unconscionable, then

they're unenforceable. They're unenforceable not only by Norvergance, but by the finance companies as assignees as well. The finance companies will not be able to collect.

In the class action, the plaintiffs are relying on New Jersey law, and contending that the grossly excessive price alone can make an agreement unconscionable, and in New Jersey, there is some case law to support that argument. They claim that it is both procedurally and substantively unconscionable because there are hidden terms, unduly complex terms, and because of the bargaining tactics that were used. With regard to substantive unconscionability, they argue the obligations are so one-sided that it shocks the conscious of the court.

ROBERT RADASEVICH: We have a question.

BONNIE MICHAEL: Oh, we have a question.

AUDIENCE MEMBER: Did the lease price include the telecom services?

ROBERT RADASEVICH: No. There was a separate monthly billing for the telecom services. But, the Norvergance lease is really just a service contract. Where there's an ancillary provision of a "good", it's really a service contract. But a finance company is unlikely to finance and give Norvergance eighty percent of the present cash value of a future income stream under a service contract that it may never perform. Norvergance wasn't going to get any money from its financing sources if the lion share of its monthly fee was for telecom services and only a small portion was for the lease of the matrix box.

So Norvergance dumped as much of the cost as they could into the price of the matrix unit and called the agreement a "lease". Well, now they had something that more traditionally gets financed by finance companies, a lease of goods. Since the bulk of the cost was put into the lease of the matrix box, there was a little monthly service contract to cover a relatively small service charge for the bundled telecom services. Because, remember, this all went under the guise that, "Your real telecommunications bill is going to be a lot less, so here's the bill. You owe us $14 a month."

AUDIENCE MEMBER: I come from New Jersey, and I was representing Banco Popular as part of this, and they kept on stating that, "We are innocent. We're not aware of these nuances." The people came to us with the paper. The paper on its face is good paper.

And I also represented people who got injured, as well as an employee of Norvergance. And I can see where the finance — there may be a question of public policy as to who’s going to bear the burden of this loss, but if you’re in the finance business and you get a hell or high
water contract, what is going to happen in the future to avoid problems like this taking place? Are we going to say then that all finance companies have a further duty to inspect the true value of what was being sold behind the paper if they can’t just rely on a commercial transaction between two businesses unless — and determine the valuation of the actual goods? I know that what was in that box was, perhaps, no more than a router.

ROBERT RADASEVICH: Correct.

AUDIENCE MEMBER: And that router could have cost maybe as much as $25, not $1,500 so —

ROBERT RADASEVICH: What you’re asking is “how do you keep this cow out of the ditch?” If you look at the Florida case, the Florida Attorney General accused the finance companies of being in cahoots with Norvergance in facilitating, assisting, and drafting or commenting on the Norvergance leases. It is alleged that absolutely no one, because of their track history of the company, knew exactly what was going on and the finance companies must have known that they were financing a lease of equipment for a hundred times its fair market value or its actual cost, retail cost.

AUDIENCE MEMBER: Just getting to your issue of public policy, which I think may end up happening with all this stuff, I had a totally different situation.

I got a case pursued where what was “leased” were “the interior improvements to a leased building.” All right? In other words, this was replacement of walls and electrical. That was the lease.

ROBERT RADASEVICH: Were you representing the lessor or finance company?

AUDIENCE MEMBER: I was representing the finance company.

ROBERT RADASEVICH: Yeah. I had one of those, too, one time, drywall.

AUDIENCE MEMBER: You can take it out, but now you’re going to have to pay the guy because it’s a fixture, and I said, you know, this is not a true lease. I said, you know, this is not a two-way situation. I said, what were you thinking? And they said, “Well, the person who did that is no longer with our company.” I said, “You think?”

So the answer to the question is, you know what — and because that ended up working out because of other reasons, but my client took a huge haircut because they were in a pickle, and frankly, I think these finance companies, even though they’re the assignees, they’re in the exact same situation. They have put themselves out and they have to have some —
ROBERT RADASEVICH: Well, the financing arrangements between Norvergance and its financing sources were not one-off assignments. Okay? Nobody goes to Banco Popular and says, “I got a one-off on financing a lease to Betty’s Beauty Shop for you.” These aren’t one-offs. Okay?

I do think that what’s going to happen is you are going to see courts imposing duties upon finance companies not to remain ignorant of the economic reality of the “leases” they are financing. Finance companies have all the benefits in the world under Article 2A. They are insulated. They just sit back and wait for the checks to come in.

Well, you know what, if society gives you the right to sit back and wait for the checks to come in, you better make sure that you have the right to collect that money and that it’s a legal contract between the lessor and the lessee to start with.

And what the attorney generals are trying to do, just because it’s not a lease, that just means that it’s governed by a different body of law, not Article 2A, and there are provisions in Article 9, Section 9-403,19 which talk about an assignee and an assignees’ rights. There are specific finance lease provisions in Article 2A, but Section 9-403 covers the general assignee.20 Because without that, assignees generally take the contract rights of the assignors.

Then there’s the whole idea of holder in due course and what Section 9-403 says, and we’ll get to that.

AUDIENCE MEMBER: You raise a really good question, but I’ve got to tell you, I had one of these Norvergance cases in early ‘04, and I said, “Let me see the lease. Oh, there’s a hell or high water clause. I guess I’ve got to enforce it. I’m sorry, you know, maybe we can sue on it. It’s a commercial lease. You’re going to spend a lot of money in legal fees, et cetera.”

So, now what you seem to tell me is that the hell or high water clause doesn’t mean anything. Maybe the venue stuff is bad. And if I’m representing a leasing company, I’m going to say, “Yeah, you better raise your rates.” I mean, isn’t this all sort of cost of goods? I mean, aren’t you going to end up saying to the leasing companies, “You guys are paying more. You’re going to break your bank. This type of leasing finance is not going to be as cheap as it once was.”

ROBERT RADASEVICH: You can put lipstick on a pig, but it’s still a pig.

AUDIENCE MEMBER: Well, it’s either a cow or a pig.

20. Id.
ROBERT RADASEVICH: I can't talk about my old tipping days. My wife won't let me.

But, you know what, I think that is right. I think that what's going to happen is that Norvergance is going to cost so much money and cause so much upheaval in the industry because attorneys generals are going to say "Oh, you know what, we just sued Norvergance, but they're in bankruptcy. But I have twenty-six different finance companies I can sue and put on my wall."

So I think what should happen is if a finance company is looking at a lease transaction which had a significant service component, they need to take whatever reasonable measures they can take to ensure that the lease is not hiding the service component in the cost of the goods. Because if they don't and there is an extraordinary difference between the amount the lessee is paying under the lease and the cost of the goods, the finance company is going to have a problem. It's not going to be a lease.

AUDIENCE MEMBER: I'm curious. Does every single lease say one matrix solo without any other —

ROBERT RADASEVICH: No, you only need one.

AUDIENCE MEMBER: I understand that. Is that a different modeling number then?

ROBERT RADASEVICH: No, there are two different — I'm sorry. I always monopolize.

BONNIE MICHAEL: My understanding is there are handsets or something like that that also has very little value.

AUDIENCE MEMBER: The reason I ask is from the standpoint, again, getting to the question of, if you will, a due diligence for the financing companies. You know, when you finance a Dell computer or you finance a car or a copy machine, a finance company can look and say, "I know what that is, but what the heck is a matrix solo?"

ROBERT RADASEVICH: Well, you know what, in order to qualify as a finance lease, Norvergance must supply its customer with a copy of the contract that Norvergance had with its vendor. So, it is one of the things that has to be done, one of the steps along the way that has to be taken, to prove you've got a finance lease.

So if the lessor has to provide the statement to its customer, the lessee, the lessor should provide it to the finance company. If I'm the guy in the finance company, with everything else going on these days, I absolutely want to see something to tell me what the cost basis in this product is before I finance the lease.
AUDIENCE MEMBER: I'm saying something else entirely. If you've got eleven thousand leases with twenty-six companies, that would be about five hundred per company. The leases have various prices for the same piece of equipment ranging from $500 a month to $2,000 a month. Based on what you're saying, it seems to me, it raises a red herring, "Hey, I don't understand how do you get this in one and that in the other." Sooner or later, it would seem to me that the financing company can't just be — particularly since there was no residual value —

ROBERT RADASEVICH: That's exactly what the Florida attorney general says, exactly what they say.

AUDIENCE MEMBER: I will tell you one other issue. On these matrix boxes, you could actually peel the matrix label off and find out the underlying manufacturer.

My guy did it. He actually peeled the label off, went onto E-Bay and found that you could get the same thing for around $100.

AUDIENCE MEMBER: The employee that I knew said he realized, after he had been there a few months, that it was the equivalent of a Ponzi scheme. But he felt that the finance company people really were not aware of the fraud, whatever that value means, and that the phone service they were providing wasn’t necessarily just for press, but they would really use the internet as a phone service, and that’s how they got the prices down so low.

ROBERT RADASEVICH: You also have a comment.

AUDIENCE MEMBER: I'm sorry, but I'm having a problem understanding why the finance companies should all of a sudden be yelling surprise when in '92 there was the equipment office deal which resulted in the principles of that corporation going to federal prison for mail fraud, same kind of lease.

And then in '99, right in Philadelphia, there was the famous credit card center case that is in bankruptcy court even today. And all the credit card center people were doing was, "leasing this little modem to all these little shopkeepers where they could swipe the consumer's credit card through it and giggle up the telephone number," and it was nothing more than a modem.

And it's the same deal, it's the same lease. Why are the finance companies now, all of a sudden, raising their hands saying, "Oh, we didn't know. We didn't know. We didn't know"?

ROBERT RADASEVICH: Here's why. Because they were paying a significant discount on that cash flow, on the present cash value of that cash flow. And they looked at all the protections in that lease
and they looked at that bottom line, "What am I paying for this paper?"

AUDIENCE MEMBER: It's greed.

ROBERT RADASEVICH: Well, absolutely. That's right. And you know what —

AUDIENCE MEMBER: I have no sympathy for them.

ROBERT RADASEVICH: — We look at the Racketeer Influenced and Corrupt Organizations ("RICO")²¹ cases, back about fifteen to twenty years ago. RICO used to be all over the place. They're few and far between now.

But here's one case that's got a RICO component in it. And you know what, this sounds like a pretty good RICO case. We have mail fraud. We have wire fraud. We have a business enterprise being conducted through those means. This one is not looking bad. And RICO has lovely treble damage provisions and provides for an award of attorneys' fees.²² I get all frisky when I think about those.

AUDIENCE MEMBER: But, you know, I don't understand how the finance companies can all of a sudden raise the innocent purchaser view.

ROBERT RADASEVICH: Well, you know what was happening? In one of those states, I think it was in Massachusetts, more and more consumer complaints were lodged with their consumer protection division, whatever the heck they call themselves. The consumer protection division sent a letter to the finance companies saying, "Guys, why don't you hold off on those collection efforts until we've had a chance to get our hands around this to see what's going on." The financing companies just ratcheted it up some more.

AUDIENCE MEMBER: Well, I think what also is interesting in this, too, was that a lot of people had their entire business, their entire communication system through Norvergence. I mean everything. Cell phones for the guys out in the field, their web page, the phone system, and all of a sudden the plug started getting pulled on this thing. I mean, companies weren't worried about paying at some point. They were worried about being out of business. I mean, that was such an egregious — I mean, remember the telephone scams back when there used to be pay phones? It was like those types of deals, but it didn't really put people out of business. This would put Betty's Hair Store or Beauty Parlor completely out of business. They were shut down.

22. Id. at § 1964.
ROBERT RADASEVICH: Yeah. But if a lot of your business is dependent upon your commerce trade and you do a lot of telemarketing out of the office and not out of India, you know, you need services. And these folks just continued to pay as long as they were provided with services. It was only until the actual service providers, the Quests and the Sprints of the world, started shutting down service because they weren’t getting paid by Norvergance. Then everything collapsed.

AUDIENCE MEMBER: Yeah. I think you got four free cell phones with your matrix. So when those went dead, my guy knew he was in trouble.

ROBERT RADASEVICH: Go ahead.

BONNIE MICHAEL: Actually, I think you’ve at least hit on most of the items that we were going to discuss, and I know that we’re running short on time.

Do we have any more questions?

ROBERT RADASEVICH: Well, let’s talk about how you keep that cow of the ditch. Okay?

If there’s a service component in the nature of whatever your company is going to finance or whatever your company is going to lease, you must make sure that the price that’s paid for the component, the “goods” component, under your lease or your financing has some rational relation to what the actual cost of that good is. That’s a must.

Even if there is no service component at all and it’s not a one-off transaction — and if it’s a one-off transaction, there ought to be enough money to justify doing it — make your client get from its seller the cost basis in that article. That’s how you protect yourself.

Because without taking those steps, your client, the finance company is now a defendant in seven different cases by the attorneys general’s offices in seven different states seeking all kinds of nasty relief, punitive damages, disgorgement of profits, and RICO violations. I don’t know what their defense is besides negligence and ignorance, and that’s just going to be a little tough to defend.

AUDIENCE MEMBER: What is the status of the litigation? I think I understood it was not stayed as to all the mom and pop lessees. What’s going on with all that?

ROBERT RADASEVICH: I did not see a ruling out of — there has been no ruling in the class action case.

And what happened is the New Jersey attorney general intervened in a pending adversary in the bankruptcy case to say, “Wait a minute. Whoa, whoa, whoa. We’re New Jersey. You’ve got to shut this all
down. You can’t let these lenders go after the ma and pa shops, shut them down.” That’s being litigated. It hasn’t been resolved yet.

But you’re right. The finance companies are still out there doing that.

BONNIE MICHAEL: But just to give you a little more specific information, there has been a motion for summary judgment as to specific parts of the complaint filed. One being that the venue clause is not enforceable, and that, I believe, has a hearing date of May 10th, so that’s where that stands.

MARK LEIPOLD: Rudy and Bonnie, thanks very much. Unfortunately, we have to stop. Given the interest of the audience, I think we could probably spend a large part of the afternoon discussing the issues created by Norvergence.