



LJN'S

Equipment Leasing

Newsletter®

Volume 27, Number 5 • June 2008

What's New In the Law

By Robert W. Ihne

The Ability to Collect Rentals Under Article 2A Finance Leases or Leases with 'Hell Or High Water' and/or Waiver Of Defenses Provisions

In a recent opinion by a Magistrate Judge, *Federal Trade Commission v. IFC Credit Corp.*, 2008 WL_1001154 (U.S. Dist. Ct. N.D. Ill. April 9, 2008), the court granted a NorVergence assignee's motion to dismiss one count of the FTC's complaint — seeking to deny enforceability of the floating forum selection clause found in the leases acquired by such assignee (such holding being consistent with the Seventh Circuit's decision in *Aliano Bros.* as noted in the Forum Selection section below) — but denied IFC's motions on two other counts. At this very early stage in the lawsuit, the court appears to be quite deferential to the FTC's arguments against IFC. Although IFC argued that the lessees — small businesses and religious and other not-for-profit organizations — were not "consumers" under the Federal Trade Commission Act, the court (indicating that this issue was one of first impression under the FTCA) was inclined to defer to the agency's interpretation of the statute, which interpretation included such lessees as "consumers." The court also listed a good number of instances of alleged complicity by IFC in

continued on page 6

What Lessors Need to Know About Antitrust

Competitors of Copier Equipment Provider Entitled to a 'Kodak Moment' in Alleging a Single Provider Relevant 'Aftermarket'

By Don T. Hibner, Jr.

The Ninth Circuit recently examined an antitrust issue with significant relevance to the equipment leasing industry. In *Newcal v. IKON Office Solution*, 513 F.3d 1038 (9th Cir., Jan. 23, 2008), competitors of a copier equipment provider, IKON Office Solution ("IKON"), alleged that defendant IKON used "fraudulent practices" to secure and lengthen its customer contracts, thus reducing the ability of competing copier equipment providers to contest for "aftermarket" business."

Although the district court had granted a motion to dismiss pursuant to FRCP 12(b)(6) on the ground that IKON did not have market power over a "unique" product or service, and that any control that it had acquired over its customers was a function of contract, and not market power, the Ninth Circuit reversed. The following article is an analysis of the relevant law of antitrust and a discussion of applicable issues that counsel should consider when marketing proprietary aftermarket equipment.

ANTITRUST LAW

In the last 50 years, there has been a sea change in the antitrust law relative to monopolization in violation of Section 2 of the Sherman Act, and tying arrangements in violation of Section 1 of the Sherman Act, and Section 3 of the Clayton Act. For example, in *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. 1945), Judge Learned Hand, his court sitting as the United States Supreme Court, held that Alcoa had illegally monopolized the market for the production of aluminum ingot, by, among other practices, increasing supply in anticipation of increased consumer demand, and the systematic lowering of prices to levels that could not be competitively matched by new entrant competitors lacking economies of scale efficiency. Other than certain allegations of an above cost "price squeeze," there was no evidence of any "predatory" or unfair or anticompetitive practices. Rather, the court's view at that time was that a monopolist had a duty to regulate

continued on page 2

In This Issue

What Lessors Need to Know About Antitrust1

What's New In the Law1

Strategic IT Decisions3

In The Marketplace8

PRSRST STD
 AUTO
 US POSTAGE PAID
 PHILADELPHIA, PA
 PERMIT #1437

Antitrust

continued from page 1

his capacity and his pricing to ensure that its smaller and more recently arrived competitors would not be disadvantaged. Currently, the law under Section 2 is that the monopolist has no duty at all: *See Verizon Comm., Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398 (2004).

In the arena of tying arrangements, the change in the law can also be described as a sea change. The early opinions of the Supreme Court assumed that “tying arrangements serve hardly any purpose beyond the suppression of competition.” *Standard Oil Co. of California v. United States*, 337 U.S. 293, 305-306 (1949). In *Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495, 498-499 (*Fortner I*), “sufficient market power” to invoke a *per se* rule of illegality was found present because of the physically “unique” attributes of the alleged tying product, which was attractive credit made available for the purchase of prefabricated buildings. The Court held that the “uniqueness” of the credit offer was sufficient evidence of “market power” to invoke a *per se* rule, without any inquiry into what other firms were capable of offering substitutable credit terms.

However, seven years later, the Court, in the same case, held that unless the plaintiff could prove “market power” in a market consisting of all of the competing products that would be available to consumers who wish to substitute away from the tie, there could be no actionable tie. *United States Steel Corp. v. Fortner Enterprises, Inc.*, 429 U.S. 610, 622 (1977) (*Fortner II*). Another seven

Don T. Hibner, Jr. is a partner in the Los Angeles office of Sheppard, Mullin, Richter & Hampton. Mr. Hibner has specialized in antitrust litigation and counseling since admission to the Bar and has been a frequent contributor to programs of the Antitrust Section, its National Institutes, PLI and other programs, as well as a contributor to various Law Reviews. He may be reached at DHibner@sheppardmullin.com.

years later, the Supreme Court made it even clearer that in order to determine the presence or absence of “sufficient economic power” to violate either Section 2 of the Sherman Act or Section 3 of the Clayton Act, there must be an appraisal of “market power” in a properly defined “relevant market,” which would consist of all reasonable substitutes confronting the seller’s demand curve, that could be readily obtained by consumers. *See Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2 (1984). *Fortner II* and *Jefferson Parish*, taken in conjunction with the Supreme Court’s seminal decision in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977) made it clear that antitrust law must be continually evaluated in light of the increased knowledge in the field of industrial organization economics. *See* D. Hibner and A. Hasegawa, *The Silver Anniversary of an Antitrust Sea-Change: Continental T.V. and Brunswick at Twenty-Five. Competition Magazine* 27 (Fall 2002).

Presumption of the Presence of Market Power

However, even with the enlightenment of *Continental T.V.*, *Fortner II* and *Jefferson Parish*, early Supreme Court decisions invoked a conclusive presumption of the presence of market power in intellectual property cases. These cases routinely condemned “requirements ties,” where the seller or lessor of patented systems required the purchase of unpatented parts or service. Pursuant to cases such as *International Salt Co. v. United States*, 332 U.S. 392 (1947), and *United States v. Loew’s, Inc.*, 371 U.S. 38 (1962), “market power,” or in a Section 2 case “monopoly power” would be conclusively presumed where the tying product was subject to intellectual property protection. *See also, International Business Machines Corp. v. United States*, 298 U.S. 131 (1936) (IBM punch card case). This line of cases has also gone to the graveyard of history. In *Illinois Tool Works, Inc. v. Independent Ink, Inc.*, 547 U.S. 281, 126 S. Ct. 1281 (2006), the Supreme Court overruled the earlier cases, which had conclusively

continued on page 5

Equipment Leasing Newsletter®

EDITOR-IN-CHIEF Adam Schlagman
EDITORIAL DIRECTOR Wendy Kaplan Amplos
SENIOR MANAGING EDITOR Julie Gromer
MARKETING DIRECTOR Jeannine Kennedy
GRAPHIC DESIGNER Louis F. Bartella

BOARD OF EDITORS

ANTHONY ALTAMURA Hahn & Hessen, LLP
New York
WILLIAM J. BOSCO, JR. Leasing 101
Suffern, NY
JAMES R. CAIRNS White & Case LLP
Los Angeles
LEWIS J. COHN Cohn & Dussi, LLC
Burlington, MA
RAYMOND W. DUSCH Schulte Roth & Zabel, LLP
New York
BETH STERN FLEMING Stevens & Lee, P.C.
Philadelphia
JAMES F. FOTENOS Greene Radovsky Maloney &
Share, LLP
San Francisco
BARBARA M. GOODSTEIN Dewey & LeBoeuf, LLP
New York
BARRY A. GRAYNOR Cooley Godward Kronish LLP
San Francisco
EDWARD K. GROSS Vedder Price Kauffman
& Kammholz, P.C.
Washington, DC
MARC L. HAMROFF Moritt Hock Hamroff &
Horowitz, LLP
Garden City, NY
ROBERT W. IHNE Bridgewater, NJ
CONSTANTINE KARIDES Reed Smith LLP
New York
ANTHONY L. LAMM Lamm, Rubenstone, Totaro &
David, LLC
Bensalem, PA
RUTH L. LANSNER Holland & Knight, LLP
New York
MICHAEL A. LEICHTLING Troutman Sanders LLP
New York
STEVEN N. LIPPMAN Rothstein Rosenfeldt Adler
Fort Lauderdale, FL
BARRY S. MARKS Marks & Weinberg, P.C.
Birmingham, AL
PAMELA J. MARTINSON Bingham McCutchen LLP
San Francisco
DAVID G. MAYER Patton Boggs, LLP
Dallas
ALAN J. MOGOL Ober Kaler
Baltimore
MICHAEL C. MULLITZ Kaye Scholer, LLP
New York
MARK I. RABINOWITZ Blank Rome LLP
Philadelphia
JEFFREY N. RICH Kirkpatrick & Lockhart
Preston Gates Ellis, LLP
New York
A. MICHAEL SABINO Sabino & Sabino, P.C.
New York
IAN SHRANK Allen & Overy
New York
ROBERT THORNTON SMITH Linklaters
New York
ROBERT VITALE Paul, Hastings, Janofsky &
& Walker, LLP
New York
HOWARD K. WEBER Societe Generale
New York

LJN’s Equipment Leasing Newsletter® (ISSN 9733-4304) is published by Law Journal Newsletters, a division of ALM. ©2008 ALM Properties, Inc. All rights reserved. No reproduction of any portion of this issue is allowed without written permission from the publisher. Telephone: (800) 999-1916
Editorial e-mail: jgromer@alm.com
Circulation e-mail: almcnc@alm.com
Reprints e-mail: lmelesio@alm.com

POSTMASTER: Send address changes to:
ALM
345 Park Avenue South, New York, NY 10160

Published Monthly by:
Law Journal Newsletters
1617 JFK Boulevard, Suite 1750, Philadelphia, Pa 19103
www.ljnonline.com

An  incisivemedia company
incisivemedia.com

Strategic IT Decisions

The Backroom Brawl

By Shawn Halladay

There have been, literally, stacks of books written describing how to establish an IT strategy, the process to be followed, methodologies, and organizational hurdles. Additionally, who knows how many trees have been sacrificed conveying these strategic findings to management?

Since the topic of how to develop an IT strategy has been thoroughly addressed elsewhere, this article discusses the business issues and challenges that are driving the need for lessors to reassess their IT strategy and approach. The focus of this discussion is on the factors management should consider as it examines the company's IT strategy for core leasing operations, *i.e.*, front-end and back-end systems.

THE ENVIRONMENT

Lessors today are operating in what has become a mature industry. Products are becoming more standardized and inching ever closer to loans and other straight financing vehicles as the leasing industry continues to move away from its original sustaining model of creating product differentiation by assuming asset risk.

A mature industry is not the only factor affecting lessors' IT decisions, however. Other drivers include:

- Margin compression;
- Shifts in the accounting paradigm;
- Perceived shortcomings of existing systems; and
- Transactional considerations.

Margin Compression. Offering loan products has put lessors in direct competition with the banks, which are stiff competitors, particularly when it comes to rate and relationships. This competition, coupled with high liquidity (prior to the sub-

Shawn Halladay is a principal with The Alta Group and also manages its Professional Development Division, the training and education subsidiary. More information on The Alta Group is at www.thealtagroup.com.

prime meltdown), has put pressure on profitability. The upshot of this competitive environment is that margins have been squeezed significantly over the past several years and have continued to shrink.

These shrinking spreads have placed pressure on management to find ways to cut costs. And cut they have. There can only be so many benefits eliminated, headcount reduced, and expense accounts purged, however, so, as a result, the cost-cutting search parties have been forced to explore ever deeper into the organization in order to discover cost-saving opportunities. Although it only was a matter of time, these searchers finally have arrived at what I refer to as the back room (or IT shop).

Armed with the knowledge that even a 10 basis point reduction in expenses translates into roughly 60 basis points of ROE, the search parties have examined every angle of backroom operations. TCF Equipment Finance, the 2007 ELFA Operations and Technology Excellence Award winner, for instance, identified its front-end process as a source of potentially significant cost savings. Working together with CapiitalStream, TCF created a seamless work flow and integrated information path from vendors and sales representatives all the way through credit, equipment management, pricing, documentation, funding, booking, and servicing.

Shifts in the accounting paradigm. There is no doubt that the convergence of FAS 13 with the international lease accounting standard is the accounting change that grabs everyone's attention. In spite of the potential impact on the market, however, convergence will not play a significant role in lessors' IT decisions. Instead, it is the fundamental shifts in accounting approach that are occurring that will directly impact IT decisions, in particular those regarding the lease management, or back-end accounting, system. Foremost among these shifts is fair value accounting.

Although leasing has received a temporary reprieve from FAS 157 regarding fair market value measurements, this accounting pronouncement, when combined with other regulatory guidelines such as Sarbanes-

Oxley (SOX), has intensified the need for asset level accounting. Lessors need the ability to track their assets, both prospectively and historically under this guidance in order to properly value residuals. For many lessors, this will mean achieving a level of detail not currently available.

The remedies in this regard are not pretty and involve implementing a new system, creating workarounds, modifying existing systems, or a combination of the above. It is interesting to note that, while in the midst of trying to achieve operational efficiency from a systems perspective, lessors are being forced into incurring additional costs. This situation does, however, point out the need for an integrated IT strategy that considers all sides of the issue.

Perceived shortcomings of existing systems. TCF, in the prior example, elected to keep its legacy lease management system in place as part of its strategic plan (A legacy system is defined as an old or outdated system that, while still functional, does not work as well as newer, up-to-date systems). Other lessors, however, are examining their competitive situation relative to the lease management, or back-end, application. These lessors are looking at back-end systems to make certain they are operationally efficient, properly aligned with the business they support, and are fully utilized from a capabilities standpoint.

It is at this point that the search for efficiency has turned into a backroom brawl as management wrestles with issues such as asset-based applications, legacy systems, and ASPs, while IT departments vigorously defend their turf. This problem is further exacerbated by the range of systems being offered, in terms of both vendors and approaches. It should be noted that there are many available lease applications, all of which function well in the space for which they are intended. I have avoided

continued on page 4

LAW JOURNAL NEWSLETTERS REPRINT SERVICE Promotional article reprints of this article or any other published by LAW JOURNAL NEWSLETTERS are available. Call Lauren Melesio 212.545.6136 or e-mail lmelesio@alm.com for a free quote. Reprints are available in paper and PDF format.
--

IT Decisions

continued from page 3

mentioning them, to the extent possible, since I do not want to appear to be endorsing any one product or, by omission, denigrating any product. Interested readers can access the full spectrum of available software providers at the ELFA Web site, www.elfaonline.org/ind/MbrDirs/software/.

The major IT decision for most lessors today, at least from a lease processing perspective, is whether to stay with the existing legacy system or move to a new platform. This decision has been made moot for some, as their parent has decided to push down an enterprise relationship, with an Oracle or SAP, into the leasing space. Unfortunately, it is not an easy decision, as there are valid pros and cons to both sides.

The advantage to the legacy system is that it already is in place, has organizational roots and, although not perceived as being perfect, is functioning adequately. Those considering changing typically complain that the legacy system just doesn't do what they need it to. This can be a tricky situation, though, and begs the question, "Is it the application that is not capable, or is it a utilization issue?"

There are several very robust legacy systems that have capabilities well beyond those perceived. My experience, and that of others, is that the intellectual capital (*i.e.*, well-trained personnel) to take advantage of these capabilities either: 1) are moved to other areas of the company; or 2) leave the company to accept another position.

This creates what I refer to as a defenestration of system capabilities. Only a portion of the knowledge and experience of the original user is passed on to the newcomers — the rest goes out the window. System effectiveness, as a result, is diminished. Management needs to consider whether an in-depth training initiative might accomplish the same result as a new application, at a fraction of the cost and without the disruption in operations.

Those vendors offering "up-to-date" systems have differing viewpoints. These vendors would argue

that the problem goes beyond one of utilization and that it is an issue of relevance. One vendor stated that "While existing legacy systems may be adequate for some organizations now, their useful lives are, by definition, assuredly waning. It is inevitable that new, more demanding business requirements are going to force firms to convert and retire systems at some point in time."

Transactional considerations.

As pointed out, another consideration in establishing the leasing IT strategy is the demands of the business. Will the existing platform meet the realities of the shifting accounting paradigm? Perhaps so, perhaps not. More importantly, is this even an issue for the company, based on its target market and product mix?

There has been a lot of buzz generated around the absolute need for asset-based lease management systems over the past several years — what were referred to as the 'wave of the future.' According to the conventional wisdom at the time, an asset-based application would eliminate many of the problems associated with upgrades, asset splits, and partial returns, to name but a few. This approach to maintaining lease data also would push the accounting down to the asset/serial number level, a result that puts the lessor in more technical compliance with FAS 13.

These all are strong arguments, but they assume that the business is an asset-based business. If the lessor is doing primarily conditional sales agreements, or 10% buyout deals, an asset-based approach does not make a whole lot of sense, and a traditional contract-based application is adequate. For a lessor with an active, residual-based business, however, the benefits of a true, asset-based application can be substantial.

CHOOSING THE APPROACH

The bulk of the debate about the efficacy of various systems has revolved around whether to stay with the legacy system or implement a new platform. As mentioned, there are positives and negatives to both alternatives. A third alternative, and one which is gaining traction in the marketplace, is to outsource the lease processing and utilize an ASP.

The benefits of doing so are the traditional ones associated with any outsourcing initiative — let someone else perform non-core functions at a lower cost. Opposition to outsourcing generally revolves around lessor sensitivity to the confidentiality and protection of their customers. Essentially, "We do not want to give up the contact and intimate knowledge that we have with our customers."

This is an interesting argument, but one that does not match up with other lessor practices such as syndication, or even the everyday experiences in our personal lives. One has to wonder if CIT, for example, who is operating multiple platforms, and in the process of shedding non-core activities, might not be better off by utilizing an ASP.

As a final consideration for those formulating an IT strategy, lessors should consider the impact on operations if their vendor is acquired by another entity or actually goes out of business. Although oftentimes relegated to the sourcing department in the company, the issue of vendor viability is one that must be addressed in some form by the C-level user.

CONCLUSION

There currently is quite a bit of bustle around leasing applications, some of which actually is resulting in system acquisitions and implementations. By the same token, there is a fair amount of inertia due to accounting uncertainties, spectacular cost overruns on new implementations, and, quite frankly, a desire to not rock the corporate boat in some cases.

Irrespective of whether the lessor chooses to remain with its legacy system, implement a new application, or outsource operations to an ASP, management must develop its IT strategy in the context of the business environment. At the end of the day, if the application does not, or cannot, support the company's business goals, there will be no cost savings.



The publisher of this newsletter is not engaged in rendering legal, accounting, financial, investment advisory or other professional services, and this publication is not meant to constitute legal, accounting, financial, investment advisory or other professional advice. If legal, financial, investment advisory or other professional assistance is required, the services of a competent professional person should be sought.

Antitrust

continued from page 2

presumed “sufficient economic power” in intellectual property cases involving “requirements ties.” A full relevant market appraisal is now a requirement in all tying cases.

Substantial progress in the application of advances in economic knowledge to antitrust principles continue at an increasing pace. See *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 127 S. Ct. 2705 (2007) (*per se* rule against vertical resale price maintenance overruled.)

BUT THEN, THERE IS STILL KODAK

In *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451 (1992) the Supreme Court affirmed a reversal of summary judgment for Kodak against charges that Kodak illegally tied the sale of replacement parts for its photocopiers and micrographic equipment to the purchase of its repair services. After holding that a genuine issue of fact existed as to whether parts and repair services constituted distinct product markets, the Court considered whether a seller without market power in the market for the sale of original equipment could possess market power in the aftermarket for the sale of parts and services. The Supreme Court accepted the lower court’s conclusion that Kodak was one of a number of competing sellers of photocopiers and micrographic equipment, and that it lacked market power in any original equipment market. Kodak argued that this alone was dispositive of the tying issue, as it clearly lacked market power in the copier and micrographic equipment market, and thus could not compel or coerce the purchase of unwanted parts. If it attempted to charge supra-competitive prices for parts, it would lose new placements of original equipment to purchasers who would avoid the tie by substituting to suppliers who offered equipment with lower total life-cycle costs.

The Supreme Court rejected this argument for basically two reasons. First, the Court found that the difficulty of obtaining meaningful “life-cycle cost data” would create a sub-

stantial pool of exploitable equipment purchasers. While sophisticated buyers might be able to protect themselves by obtaining life-cycle cost information, others might not. Second, the cost of switching would disincentivize existing owners of Kodak equipment from buying competing equipment from competitors, and would thus be “locked in” to Kodak’s ability to charge higher than “competitive” prices for its aftermarket replacement parts. This would be particularly so, if the percentage of locked-in users was high relative to potential new purchasers.

The Court emphasized that it was reviewing the case to determine whether, on a motion for summary judgment, there was a genuine issue of fact that could support the allegations of the complaint. At trial, a trier of fact, whether judge or jury, could find that the relevant market for the determination of the presence or absence of substantial market power was Kodak copiers themselves, and not the array of substitutable equipment available to a potential customer who was not “locked in,” and was not a captive to Kodak because of the information asymmetry which would enable Kodak to charge non-competitive prices in the aftermarket for its parts.

In the wake of *Kodak*, several courts of appeal applied it to tying cases, and limited the relevant market to the defendant’s equipment sales alone, thus insuring that the defendant would be found to have “monopoly power” over its own sales. At first, the *Kodak* decision was heralded as a throwback to an earlier era, where franchise antitrust claims would be more sustainable by plaintiffs. See, e.g., Janet L. McDavid and Richard M. Steuer, *The Revival of Franchise Antitrust Claims*, 67 *Antitrust L.J.* 209 (1999). However, the vast majority of court decisions have limited the *Kodak* aftermarket analysis to *Kodak*-specific facts. The analysis has been generally limited to situations where the alleged tied products requirement is first disclosed to the purchaser *after* the customers are “locked-in” by virtue of previous purchase of the tying product. Such courts have generally limited *Kodak* of

situations where the defendant has changed its aftermarket sales and pricing policy after a significant number of customers have made their purchase, or a significant number of purchasers can actually show that they were misinformed about aftermarket prices, at the time of contract formation. See, e.g., David A.J. Goldfine and Kenneth M. Vorrasi, *The Fall of the Kodak Aftermarket Doctrine: Dying a Slow Death in the Lower Courts*, 72 *Antitrust L.J.* 209 (2004).

The most influential article, however, that has been instrumental in limiting *Kodak* to a “Kodak moment” is Benjamin Klein and Lester F. Saft, *The Law and Economics of Franchise Tying Contracts*, 28 *J.L. & Econ* 345 (1985). In their pre-*Kodak* article, economists Klein and Saft demonstrate that absent an aftermarket change or misrepresentation, the market power component in a franchise or requirements tie case should be determined by an analysis of the competitive inputs available to a potential purchaser at the time of contract formation. If the potential purchaser is reasonably apprised of the potential of downstream “installed base opportunism,” he or she may substitute away from the proposed tie, and make competitive market decisions. Thus, absent aftermarket policy changes, subsequent to contract formation, and absent fraudulent or deceptive practices that could prevent the potential purchaser from obtaining the necessary product or service life-cycle information, the relevant market for determining “market power” should be all of the substitutes confronting the demand curve.

THE KLEIN & SAFT ANALYSIS

Numerous courts have adopted the Klein & Saft analysis, as cited with approval in *Queen City Pizza v. Domino’s Pizza*, 124 F.3d 430 (3d Cir. 1997). *Queen City* held that the relevant market for determining the presence or absence of market power in a pizza franchise was all available franchise opportunities for pizza and fast food operations. One commentator has opined that the denial of certiorari in *Queen City Pizza*

continued on page 6

Antitrust

continued from page 5

“started the “death knell” for tying claims in business format franchise cases. Absent after the fact changes in parts of services distribution policy, all competing products available to the purchaser at the time of contract formation should be included.

The recent *IKON* decision in the Ninth Circuit confirms that while *Kodak* is not “dead,” and remains a viable decision of the United States Supreme Court, it will be limited by lower courts to its specific facts. In *IKON*, the court reasoned that the allegations of the complaint presented a closer factual analogy to *Kodak* than to *Queen City Pizza*. Thus, there was a genuine issue of fact whether the alleged market power flowed from the contractual terms between the defendant and its customers, or from

traditional acts of exclusionary conduct, that differentiated a single product market from a broader market of interchangeable competing products.

In an enigmatic of somewhat metaphysical analysis, the *IKON* court held that allegations of fraudulent contract opportunism warranted the conclusion that the defendant’s market power *could* be a function of market imperfections and the lack of substitutability, rather than from the contract itself. Noting that the “new lease on life” of the complaint may be somewhat fleeting, the court also noted that nothing in its decision guaranteed that — or even speaks of whether — Newcal’s complaint will “survive” a motion for summary judgment. Thus, the application of *Kodak* in *IKON* may indeed be a “Kodak moment.” An issue that may be decided on summary judgment is whether the contract opportunism allegations are such that

they could not have been anticipated at the time of formation.

CONCLUSION

The moral of this story? A seller or lessor of a product that wishes to mandate or encourage the sale of its proprietary aftermarket parts or service in a “requirements tie” situation will be well advised to include appropriate recitals in the Sale or Lease Agreement as to the obligation of the potential purchaser to investigate and assimilate product life-cycle information, and to agree that there may well be changes in the seller’s aftermarket parts and service policies, depending on a number of business factors, which should be identified and quantified, wherever practicable. This may do much to mutate a *Kodak* moment into a *Queen City Pizza* experience.



What’s New in the Law

continued from page 1

NorVergence’s fraudulent scheme sufficient to warrant a trial.

Although difficult to tell for certain, some of the statements made by the court may betray a lack of understanding of financing industry practice. For example, the court refers to IFC’s purchase of leases “at a discount” — perhaps implying that IFC knew it was purchasing questionable paper — when what IFC paid may have merely equaled the present value of an aggregate payment stream, computed using an ordinary and reasonable discount rate of interest. In addition, the facts that: 1) the lessees appear to have been obligated by the waiver of defense clauses in the leases to continue paying IFC even if the lessees had defenses to paying NorVergence; and 2) IFC could argue that the leases were stand-alone equipment leases rather than a part of an integrated package of services, were both characterized as parts of a “scheme.” In any event, to the extent that an assignee can be proven to have been aware of or part of a deceptive and fraudulent scheme, the UCC would not permit such an assignee to take advantage

of a waiver of defenses clause — whether or not the lessees are justifiably characterized as consumers.

DOLPHIN CAPITAL CORP. v. SCHROEDER

In what may be the latest tactic employed by NorVergence lessees to avoid having to pay assignees of NorVergence leases, the seven lessees in *Dolphin Capital Corp. v. Schroeder*, 2008 WL 630602 (Mo.App. March 11, 2008), a consolidated appeal, had obtained dismissals of the cases by the assignee in the lower court, which dismissals were affirmed by this court of appeals — after convincing the court that NorVergence was an indispensable party to the action. Since NorVergence had been prevented by its bankruptcy from joining in pending litigation by its customers, this Missouri court needed to decide whether proceeding in the “necessary” party’s absence would unduly prejudice the lessees. The court found that the lessees’ burden of proving fraud in the factum and fraud in the inducement without NorVergence is too great to permit the suit to proceed. One influence on the court appears to be “the disturbing inferences arising from the actions of

Dolphin and NorVergence” —including the fact that Dolphin continued to purchase leases from NorVergence after learning of numerous immediate complaints by other NorVergence lessees against whom Dolphin had already instituted collection actions. Aside from mentioning such suspicions concerning Dolphin, the court did not discuss the distinction between fraud in the factum and fraud in the inducement, and the potential effect of such a distinction on the assignee’s right to collect.

WELLS FARGO FINANCIAL LEASING, INC. v. MOUNTAIN RENTALS OF GATLINBURG, INC.

In affirming a lower court summary judgment in favor of a lessor’s assignee in *Wells Fargo Financial Leasing, Inc. v. Mountain Rentals of Gatlinburg, Inc.*, 2008 WL 199855 (Tenn.Ct.App. Jan. 24, 2008) (slip copy), the Court of Appeals cited a number of cases (including a number on this What’s New in the Law list) that either enforce the “hell or high water” nature of a lessee’s obligations under an Article 2A finance lease, or enforce a lease’s waiver of defenses provisions — notwithstanding the

continued on page 7

What's New in the Law

continued from page 6

lessee's unhappiness with the equipment and with the original lessor's maintenance of such equipment. In holding that this type of finance lease is not unconscionable or inequitable, the court instructively cites a couple UCC treatises while stating, "Normally, a lender who enables a buyer to acquire the goods is not subject to a refusal by the buyer to repay the loan if the goods are not what the buyer expected. Similarly, a finance lessee cannot refuse to pay a lessor an agreed payment ... The parties entered into a financial transaction in which the lessor is lending money and dealing largely in paper, not goods ... The statutory scheme of finance leases benefits both parties. The lessor gains certainty and security for its extension of credit. The lessee forgoes its warranty claims against the lessor but becomes a statutory third party beneficiary of the supply contract between the manufacturer or other supplier and the lessor."

WESTERN PETERBILT, INC. v.

LOZANO

In *Western Peterbilt, Inc. v. Lozano*, 2008 WL 1778324 (Wash.App.Div. April 21, 2008) (unpublished opinion), after a lessee had made several late payments under its lease and then failed to abide by a lessor offer to bring itself current, the lessor terminated the lease, repossessed one of two trucks being leased and filed suit to repossess the other. Although the lessee argued that the lessor had waived its rights to terminate the lease and repossess the trucks by initially accepting late payments (along with late payment fees), this appellate court affirms summary judgment in favor of the lessor by the trial court, citing language in the lease

Robert W. Ihne is an attorney with 25 years of experience in commercial financing, primarily in the areas of secured transactions and equipment leasing. He may be reached at rihne@optonline.net. The author gratefully acknowledges the assistance of **Erin Staton** and **Ed Gross** of Vedder Price Kaufman & Kammholz, P.C. in the preparation of this update.

providing: 1) for multiple remedies for default; 2) that no choice of any one remedy served to exclude exercise of others; and 3) that no waiver of a default is a waiver of any other default or subsequent breach.

A decision in *Holmes v. General Electric Capital Corp.*, 2008 WL 794580 (U.S. Dist. Ct. M.D. Ga. March 20, 2008) (Slip Copy) affirms the holding of a Bankruptcy Court that GECC was entitled to apply security deposits that it held and to claim further damages based upon a series of agreements (including a lease, an amendment to the lease requiring payment of a re-marketing fee, a security deposit agreement, and a cross collateral/cross default agreement) relating to the use of aircraft financed by GECC. The Bankruptcy Court's findings that GECC acted according to the terms of these agreements and in good faith were all affirmed.

FAIRBROOK LEASING, INC. v.

MESABA AVIATION, INC.

After the Eighth Circuit had previously determined that a "Term Sheet Proposal" evidenced a binding preliminary agreement between the parties (in 2005: 408 F.3d 460), the lessor in *Fairbrook Leasing, Inc. v. Mesaba Aviation, Inc.*, 2008 WL 564699 (U.S. Ct. App. 8th Cir. March 4, 2008) brought an action seeking expectancy (benefit-of-the-bargain) damages (e.g., for lost profits) for breach of the term sheet agreement. The Circuit Court here affirmed the District Court's holding that the type of preliminary agreement evidenced by this term sheet (what federal courts in New York had called a "Type II" agreement in which the parties bind themselves to negotiate the final terms of a contract while complying with the terms of the preliminary agreement, as opposed to a "Type I" agreement that evidences essentially complete agreement on all material issues) does not warrant the award of expectancy damages.

After determining that the first of two contracts at issue, although providing for a mixture of goods and services, was predominately for the lease of goods and thus governed

by Article 2A, the court in *Frank's International, Inc. v. Smith International, Inc.*, 2008 WL 126630 (Tex. App. Jan. 14, 2008) analyzed the effect of a mutual agreement by the parties to cancel this contract when entering into a second contract. Citing 2A-505's provision stating that following cancellation of a lease any rights based on prior defaults survive such cancellation (along with the retention of certain remedies) unless the parties have agreed otherwise, the court overturns a lower court's ruling that the rights of the lessor had been extinguished by the cancellation.

In granting a lessor's motion for summary judgment, the court in *Barr International, Inc. v. Paradise Produce Company, Inc.*, 2008 WL 162849 (Del. Super. Jan. 7, 2008) (unpublished opinion — not reported in A.2d) brushed aside the lessee's assertion that the lessor is limited to the measure of damages set forth in Article 2A's Section 528, by noting that the introductory language of such Section provides an exception permitting the lease agreement itself to determine the damages for breach. In this case the lease provided, among other things, that the lessor could require the lessee to purchase the goods for a designated amount. Such amount plus other accrued unpaid charges minus the amount realized by the lessor from a sale of the goods was awarded to the lessor as its damages.

PARMIST FUNDING CORP. v.

SUFFOLK VASCULAR ASSOCIATES, PLLC

A New York trial court in *Parimist Funding Corp. v. Suffolk Vascular Associates, PLLC*, 2008 WL 399156, 18 Misc.3d 1131(A) (N.Y. Sup. Jan. 30, 2008) (Slip Copy) refused to enforce an automatic renewal provision in three leases of medical and office equipment, citing the lessor's failure to provide advance written notification as required by New York's General Obligation Law Section 5-901. The court first brushed aside the lessee's contention that because the leases were security interests rather than true leases, the lessee should be considered to own the equipment

continued on page 8

IN THE MARKETPLACE

State Bank of Long Island, NY, has signed an agreement with **Main Street Bank** of Kingwood, TX, for the sale of substantially all of the assets of State Bank's leasing subsidiary, **Studebaker-Worthington Leasing Corp.** Studebaker will operate as a division of Main Street Bank and continue its national equipment leasing business from its present office in Jericho, NY. Studebaker's senior management, including **Kenneth Paston**, its Chief Executive Officer, will continue with the company. The sale is scheduled to close in the second quarter of 2008. State Bancorp, Inc. is the holding company for State Bank of Long Island, the largest independent commercial bank headquartered on Long Island.

Aquiline Capital Partners of New York announced that **Laird M. Boulden** has joined the firm as a senior adviser. Boulden, a long-time member of the commercial finance industry, served most recently as president and Chief Executive Officer of RBS Asset Finance, a subsidiary of Citizens Financial Group. Prior to joining RBS Asset Finance, Boulden was founder and president of **RBS Lombard**, where he was responsible for the consolidation and integration of the U.S.-based RBS equipment finance businesses within **Citizens Financial Group**. At Aquiline, a private equity firm investing in financial services, Boulden will be responsible assisting in the evaluation of future opportunities in the commercial and specialty finance sectors.

RVI Group of Stamford, CT, announced that **John O'Bryan** has been promoted to senior vice president, commercial equipment. He will be leading the company's efforts insuring general aviation and commercial aircraft residual values. O'Bryan joined RVI in 2001 after four years at **CIT Group** as vice president structured finance. Prior to CIT, O'Bryan was with **Deutsche Bank** in Dublin, Ireland and Sydney, Australia.

Balboa Capital Corporation of Irvine, CA, has promoted **Phil Silva** to president. Immediately before Silva joined Balboa in April 2007, he ran his own management-consulting firm. Prior to that, Silva was the general manager for the Healthcare and Franchise segments at **American Express Business Finance** up until and through its purchase by **Key Equipment Finance**. **Patrick Byrne**, the founder and current president of Balboa, will continue as the chief executive officer and chairman. The company is the largest privately-held equipment finance company in the US.

NationaLease, of Oakbrook Terrace, IL, has announced that through its relationship with **ATS Investment Holdings Inc.**, it has made its first investment by taking an equity position in **Stitzel Leasing LLC** of York, PA, which will now operate under the name of **York NationaLease**. In April, NationaLease established a private equity fund to enable an ownership transition of existing NationaLease member companies and provide an opportunity for new ownership to

gain viable entry as an independent lessor in the truck leasing and rental industry. The goal of the private equity fund is to preserve the legacy of the independent truck lessor, protect jobs, give customers clear alternatives, and continue to strengthen NationaLease, an already 700-plus location strong organization representing more than 150,000 vehicles. The investment by ATS enabled **Stitzel Leasing** to acquire the former York NationaLease. Currently, Stitzel operates more than 100 vehicles from a single York, PA, location. The firm is in the process of opening a location in Harrisburg, PA, and plans to add additional York NationaLease locations in the future.

General Finance Corporation of Pasadena, CA, and **Royal Wolf Trading Australia Pty Ltd**, an 86.2%-owned subsidiary that is the largest marketer and lessor of storage containers in Australia, have announced the acquisition of **RWNZ Acquisition Co. Limited** and its wholly owned subsidiary **Royal Wolf Trading New Zealand**, believed to be the largest marketer and lessor of storage containers in New Zealand, for approximately USD \$18.6 million. Through this acquisition Royal Wolf acquired more than 5,800 storage containers, of which approximately 5,000 storage containers are in the leasing fleet at approximate 86% utilization rates, that are primarily delivered through five branches or customer service centers. The transaction will be primarily financed by bank financing under the existing Australian and New Zealand Banking Group Limited credit facilities to Royal Wolf.



What's New in the Law

continued from page 7

and have no further obligations after the end of the original 60-month terms (employing some questionable precedent, however, to reach the conclusion that they were true

leases). What seems odd about this decision is that although the court states that "the leases obviously become month-to-month leases as they are terminable upon 30 days' notice by either party," it ignores the exception contained in Section 5-901 for the advance notice requirement

with respect to automatic renewal terms of thirty days or less. The court does, however, note that claims by the lessor sounding in conversion, replevin and for the value of the equipment are not precluded by Section 5-901.



To order this newsletter, call:
1-877-ALM-CIRC

On the Web at:
www.ljnonline.com