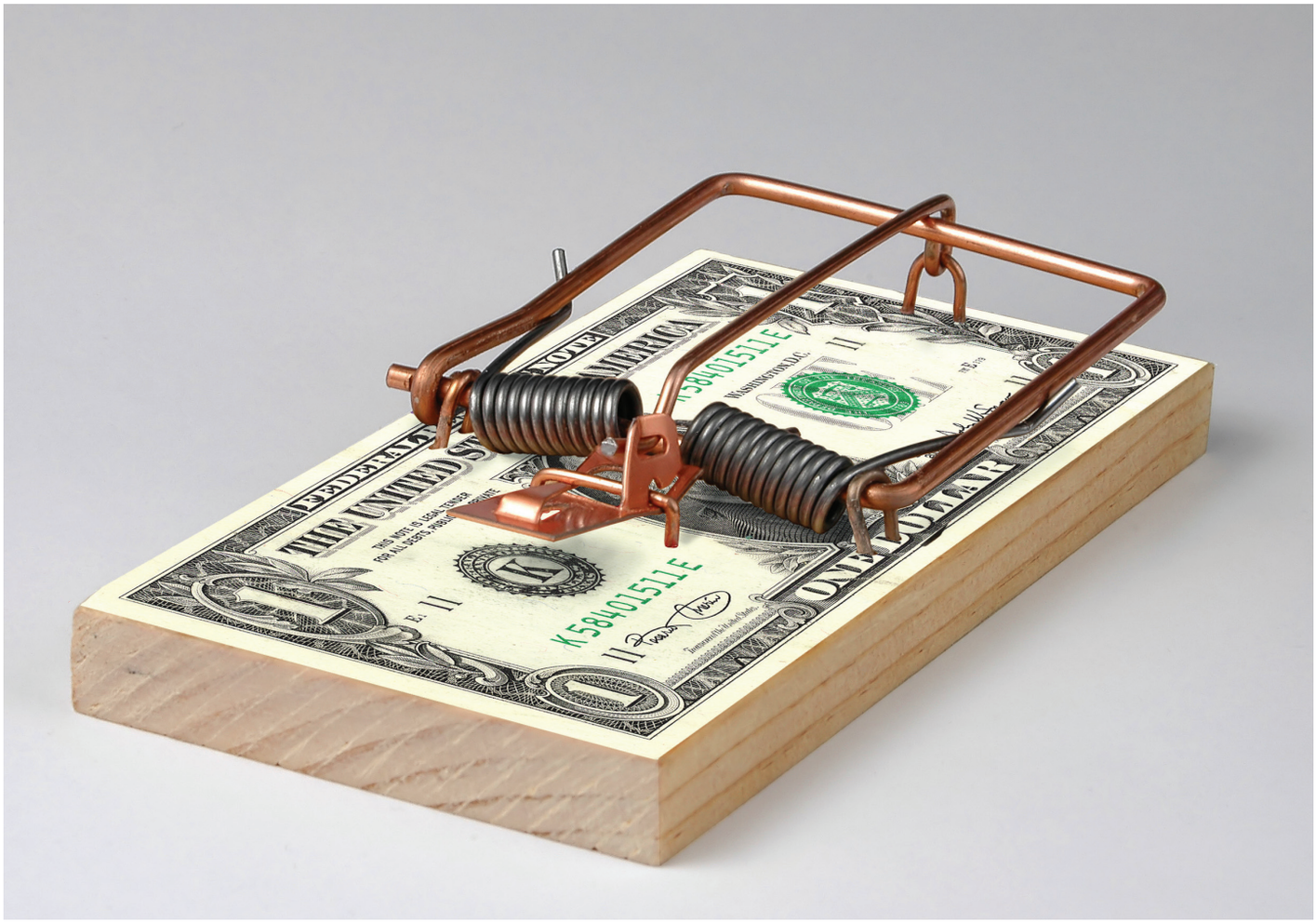

POTENTIAL PITFALLS OF FRAUD IN SMALL TICKET TRANSACTIONS©

BY MARC L. HAMROFF AND TERESE L. ARENTH

A recent decision by New York's highest state Court, the New York Court of Appeals, highlights the potential pitfalls that may befall a lessor and its corporate officers when their lessee is given the fast shuffle by a sales representative.

How often does the hectic, fast-paced leasing world of small and micro-ticket transactions lead to increasing efforts to streamline the documentation process? It is a fact of life that most people entering into relatively small transactions do not read the agreements they sign with any particular care, assuming that they even read them at all. Even if they do read the agreement, few lessees focus on the legal implications of many of the boilerplate clauses found in a lease agreement. These circumstances have led to legal claims against lessors. Many of these claims are grounded in theories advocating a "protection" of the small business lessee, in a quasi-consumer protectionist manner.

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A recent decision by New York's highest state Court, the New York Court of Appeals, highlights the potential pitfalls that may befall a lessor and its corporate officers when their lessee is given the fast shuffle by a sales representative. In Pludeman v. Northern Leasing Systems, Inc., 10 N.Y.3d 486 (2008), plaintiffs were small business owners from various states, including Missouri, Texas, Washington and New York. Defendant Northern Leasing Systems, Inc. ("NLS") and the individual defendants, its top management, were financiers of business equipment for mostly small and micro-ticket sized transactions. Plaintiffs entered into written lease agreements and personal guarantees with NLS for point of sale equipment. Plaintiffs alleged that they were deceptively caused to sign the leases that were presented to them by defendants' sales representatives as an apparent one-page contract, when in fact the leases consisted of four pages containing onerous and material terms that had been purportedly concealed from plaintiffs. According to plaintiffs, the single page presented to them appeared to cover all of the material terms of a contract, including name, address, schedule of payments, bank and equipment authorizations, the lease term amount and a signature block for both parties. Plaintiffs later discovered other allegedly onerous terms in the other three pages, including, among others: provision for automatic electronic deductions of potentially unlimited duration, a no cancellation clause, a no warranties clause, absolute liability for insurance obligations, a late charge clause, provisions for attorneys' fees, and a New York venue provision.

Plaintiffs acknowledged that the bottom of the first page of the contract read "page 1 of 4" and that the first page, in the paragraph authorizing automatic deductions, referenced paragraph 11 (found on page 3 of the contract). Despite this, plaintiffs' primary contention was that the circumstances under which they were presented with the main first page was allegedly fraudulent, claiming that the "page 1 of 4" notation, allegedly in "microprint", was insufficient, under the circumstances, to apprise them of the lease's continuation and that they were rushed into signing the contract without being given a complete, executed copy. To obtain a copy of the executed lease, plaintiffs had to use a 1-800 number to request one from NLS. Plaintiffs alleged that they did not become aware of the "hidden" pages of the lease until they attempted to either cease the electronic deductions or terminate the lease altogether.

Although plaintiffs alleged that NLS and its corporate officers all perpetrated a nationwide scheme to defraud customers, the only individualized allegations against the corporate officers were a recitation of their corporate position. Absent from the complaint were any allegations to connect the officers with the fraud. Despite this, the Court of Appeals held that the extensive nature of the scheme, as alleged, gave rise to a reasonable, rebuttable presumption that the officers, given the key positions they held, knew of and/or were involved in the fraud.

In upholding the fraud claim against the officers, the Court relied heavily on Polonetsky v. Better Homes Depot, Inc., 97 N.Y.2d 46 (2001), where it found an inference of an officer's knowledge of or participation in the corporation's fraudulent sales scheme, arising from allegations that the officer was actively involved in the corporation's marketing and sales activities. A key factor supporting this inference was the degree of the officer's personal activities. The Pludeman decision greatly stretched the reach of this inference by applying it to officers against whom no specific allegations were made. Although New York law requires that fraud claims be plead with particularity, the Pludeman decision moved away from this statutory mandate and creates potential for abuse of fraud claims against corporate officers, who will be left without means to successfully defend against this inference at the pleadings stage.

Unless tempered by subsequent case law, the Pludeman decision has potential to allow broader fraud claims to survive the pleading stage and thereby increase the lessee's leverage in litigating lease claims with the lessor. As noted by the dissent, not all of the officers' corporate titles even suggested a connection with the sales and leasing functions of NLS. One individual defendant was merely alleged to be "Vice President and Chief Information Officer", with nothing more alleged of his supposed connection to the alleged fraud. In upholding the complaint against the VP and CIO, the Court left uncertainty as to what relationship, if any, is required to exist between the corporate title and the alleged fraud, as well as how far into the corporate structure this inference may reach.

The fraud claim in Pludeman could have been avoided entirely, had better care been taken by the lessor and the sales representatives when dealing with the lessees. This case highlights the importance of readily providing a lessee with a copy of the agreement (both before and after execution), as well as clearly and prominently noting the material terms of the agreement and its number of pages, in legible, bold and conspicuous print. For belt and suspenders, have the lessee initial a bold and conspicuous statement that it has read the agreement and understands its terms or have the lessee initial each individual page of the agreement. These simple steps could mitigate against potential claims of fraud or serve as a defense to any such claims. ■

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