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Second Circuit Update

Merchant Lacks Standing to Assert Antitrust Claims Against Credit Card Companies for Chargeback Fees; and Paycom Billing Svcs., Inc. v. MasterCard Int'l, Inc., 2006 WL 3041938 (2d Cir. Oct. 27, 2006)



The Second Circuit recently upheld the dismissal of a merchant's complaint against MasterCard International, Inc. because the merchant lacked antitrust standing under the Sherman Act and had not properly alleged concerted activity on the part of the defendant network.

Factual Background

MasterCard is one of four national operators of a global card-payment network that provides the infrastructure and network services for the authorization, clearance and settlement of MasterCard payment-card transactions. It is essentially a joint venture comprised of and owned by more than 20,000 member banks who engage in the payment-card business for profit. MasterCard is funded by the service and transaction fees its members pay. A portion of those fees is held as security for merchants in the event a member bank defaults on a payment.

MasterCard's members are divided into two groups: "issuing banks," which disseminate the branded payment cards to individuals and act as intermediaries between the network and cardholders, and "acquiring banks," which contract with merchants to purchase the MasterCard transactions and serve as intermediaries between the network and the merchants who accept MasterCard payments.

Plaintiff Paycom Billing Services, Inc. is a merchant who sells access to password-protected websites owned by independent entities — largely sexual or adult-content websites. Paycom accepts MasterCard for payment for its services. In that capacity, Paycom is a merchant purchaser of MasterCard network services who has contracted with one of the network's acquiring banks. Under its contract with the bank, Paycom submits consumers' MasterCard transactions for authorization and payment. After receiving authorization and payment from the acquiring bank, less a transactional fee or merchant discount, Paycom credits the accounts of its customer websites in the amount of the transaction, less a fee for arranging the transaction.

All of Paycom's transactions at issue were of the card-not-present variety, that is, Paycom never saw the card but rather acquired the account number and verifying information online or by telephone. When this type of transaction is disputed, the issuing bank receives the funds back from the acquiring bank, which then seeks the funds from the merchant, who has paid a non-refundable merchant discount. This is called a chargeback. In such situations, the merchant bears the loss of the full purchase price because there is no signed receipt. If the merchant client of an acquiring bank has excessive chargeback activity, the acquiring bank is subject to fines and penalties, which are passed on to the merchant.

Claims of Illegal Practices

Paycom found fault with a system that forces it to pay merchant fees for transactions for which it receives no benefit. Paycom also claimed that MasterCard uses an arbitrary and onerous chargeback fine and penalty program, through which Paycom has incurred substantial fines. Such fines, Paycom contended, result in card-not-present merchants paying a supracompetitive price for fraud. Paycom also claimed its output and that of the other merchants like it has been reduced because they have been forced to enact costly measures to combat fraud, which result in the turning away of honest customers. Paycom contended that MasterCard violated the Sherman Act because its failure to offer card-not-present merchants a payment guarantee similar to card-present merchants — who can produce a signed receipt to avoid a chargeback — was the result of an unlawful conspiracy not to compete with respect to the costs or risks of card-not-present fraud and chargebacks. Paycom also contended that the system of imposing chargeback fines and penalties on merchants for fraud constitutes price fixing among the member banks.

In addition to targeting MasterCard's chargeback system, Paycom took umbrage with MasterCard's Competitive Programs Policy, which provides that member banks may not participate with issuers or acquirers from any other network except Visa's. Paycom claimed that this rule prevents competition in the market for network services and reduces the number of payment options available to it. The lack of competition has allowed MasterCard to impose higher interchange fees, onerous chargebacks and generally more burdensome rules.

Further, Paycom claimed that MasterCard's Cross-Border Acquiring Rules, which prohibit non-U.S. banks from acting as acquiring banks for internet merchants, limits the number of acquiring banks with which Paycom may contract. Paycom contended that this is an unlawful market allocation scheme that insulates U.S. banks from foreign competition in connection with the provision of services to internet merchants.

Threshold Legal Standards

The Sherman Act prohibits unreasonable restraints on trade. To recover, a plaintiff must show that it suffered an antitrust injury, that is, a loss that stems from a competition-reducing aspect or effect of the defendant's behavior. The Clayton Act allows private citizens to sue under such a federal antitrust law, provided they can demonstrate antitrust standing. Factors relevant to standing, sometimes known as the "efficient enforcer" factors, include: 1) the directness or indirectness of the asserted injury; 2) the existence of an identifiable class of persons whose self interest would normally motivate them to vindicate the public interest in antitrust enforcement; 3) the speculative nature of the alleged injury; and 4) the difficulty of identifying and apportioning damages among direct and indirect victims in order to avoid duplicative recoveries.

The Court's Decision

The Court noted that Paycom never alleged that MasterCard requires the chargebacks at issue. The chargebacks are assessed against the acquiring banks and not the merchants. Each issuing bank decides on its own whether to issue a chargeback. Further, MasterCard's levy of fines and penalties for excessive chargeback activity is assessed against the acquiring banks and not the merchants. Therefore, Paycom is an indirect purchaser. Even if the acquiring banks passed every fine, penalty or chargeback on to Paycom, Paycom would still be an indirect payor of those fines, penalties and chargebacks and therefore would lack antitrust standing.

The Court also held that the complaint fails because Paycom did not allege the requisite concerted activity among the banks. While an agreement among the banks to pass all the costs of fraud on to card-not-produced merchants may have been *per se* violation, Paycom did not allege that the banks agreed jointly to do so. The Court noted that nothing in the complaint alleged that MasterCard's rule prevented the merchants from negotiating with the acquiring banks to create an alternative to Paycom's fraud costs.

Next, the Court held that Paycom lacked standing to enforce its claims against MasterCard in connection with the Competitive Programs Policy because Paycom was not an "efficient enforcer." The Court held that Paycom's injuries were indirect and its losses caused by the program speculative. In addition, Paycom is not an entity whose self interest would motivate it to vindicate the public interest in antitrust enforcement. Finally, if parties such as Paycom were allowed to prosecute actions such as this, quantifying damages would be speculative and recoveries duplicative.

Turning to Paycom's last claim, the Court noted that Paycom did not state an antitrust claim because the complaint did not allege that the Cross-Border Acquiring Rules have an anticompetitive effect on Paycom. Paycom conceded that many banks issue MasterCards. Hence, the Court held, a policy that excludes some possible entrants to the market does not impact competition where there are so many other options. Therefore, the Second Circuit affirmed the district court's dismissal of Paycom's complaint in its entirety.

Railroad Company May Not Intervene in Action by Produce Supplier to Recover Proceeds from PACA Trust

"R" Best Produce, Inc. v. Shulman-Rabin Marketing Corp., 2006 WL 3040061 (2d Cir. Oct. 26, 2006)

The Second Circuit recently denied the application of a railroad company to intervene in an action brought by a produce supplier against a produce dealer to recover the proceeds of a trust formed pursuant to the Perishable Agricultural Commodities Act ("PACA").

Plaintiffs were suppliers of perishable agricultural goods who shipped their goods to be sold at the Hunts Point Terminal Market in New York City. Defendant dealer received and sold the produce at the market. Union Pacific Railroad Company transported the goods from the suppliers to the dealer for several years. The dealer eventually defaulted on its payment obligations to the suppliers and Union Pacific, giving rise to this suit by the suppliers. The suit was to enforce the trust provisions of PACA, which require dealers to hold perishable agricultural goods purchased on short-term credit and the proceeds from the sale of those goods in trust for the benefit of the unpaid sellers until full payment has been made. Since the defendant dealer's assets were insufficient to pay all of its creditors, only produce sellers were notified on this suit. Union Pacific moved to intervene, not as a trust beneficiary, but to recover its transportation costs of shipping the produce — an amount it argued was an administrative expense of the trust.

The issue framed by the Court was whether or not Union Pacific was entitled to be paid before the trust beneficiaries for so-called administrative expenses of the trust. If it was not, its intervention request would be denied.

To determine the outcome, the Court looked at the legislative intent behind the revision of PACA in the 1980s. It noted that Congress had inserted additional protections for sellers due to a sharp increase in the number of defaults among produce buyers. One such protection was the provision that dealers shall hold sale proceeds in trust for the benefit of all unpaid suppliers or sellers of such commodities. The purpose of the amendment was to protect unpaid sellers until full payment was made. The Court noted that it was the unequivocal intent of PACA to make trust assets available for the exclusive benefit of the produce suppliers. As Union Pacific was not a produce supplier, it could not benefit from the protections afforded under PACA.

Union Pacific argued that although it is not a beneficiary, under the common law of trusts, it should be able to recoup its transportation costs as administrative expenses of the trust. Although the Second Circuit has previously held that PACA trusts are governed by the common law of trusts, the Court made it clear in this case that common-law trust principles apply only to the extent that they do not contravene the language of PACA itself. Allowing Union Pacific to recover its costs from the assets of the trust before the beneficiaries were paid in full would contradict the language of PACA and its regulations, the Court held.

Further, since Union Pacific provided its services directly to the defaulting dealer and did not act at the Court's direction or for the exclusive benefit of the beneficiaries, to characterize its costs as trust expenses would open a floodgate of litigation from creditors misbranding the true nature of their claims. Finally, the Court refuted Union Pacific's claim that its costs fell under PACA's allowance for "contemplated expenses," because PACA is clear that the trust is for the sole benefit of the produce suppliers. Therefore, the Second Circuit affirmed the district court's denial of Union Pacific's motion to intervene.

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