



Reserve Funds and Restitution: Government Litigation in the Payments Space

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Beginning in earnest in 2013, the Federal Trade Commission (“FTC”) began to exert pressure on the payments industry—including payment card processors and independent sales organizations (“ISOs”)—to stamp out businesses engaged in consumer fraud. More recently, it has been joined in its effort, dubbed by some as “Operation Choke Point,” by the Consumer Financial Protection Bureau (“CFPB”). Together, these government agencies have pursued businesses in the payments industry on the theory that they are admitting certain merchants allegedly engaged in fraud into the payments ecosystem, thereby enabling them to harm consumers. These attacks against businesses in the payments industry come in two primary flavors, each with its own distinct defense strategies. Understanding those strategies, and where the pressure points are in the government’s case, can help ensure a more favorable resolution—whether in or outside of the courtroom.

Recapturing Reserve Funds. The FTC or the CFPB may pursue processors (and in some cases, ISOs) to capture “reserve funds,” which are proceeds of a merchant’s transactions that the processor holds and uses to satisfy consumer-initiated chargebacks—transaction “reversals” designed to make consumers whole. But even though satisfying these chargebacks is the ultimate purpose of the reserve funds, the government will still sometimes come knocking at the processor’s door, brandishing an asset freeze order against the merchant (obtained in litigation to which the processor may not even be a party) and demanding turnover of the reserve funds. In its more extreme positions, the government has even tried to sanction processors for satisfying chargebacks out of the reserve funds as a form of contempt.

When facing this type of governmental challenge, some of the most effective strategies include showing that neither the processor (or ISO) nor the reserve funds are subject to the asset freeze order. Asset freeze orders usually cover only the merchant-defendant, their employees, agents, and those in “active concert or participation with them.” Processors and ISOs frequently fall into neither category, having at most an arm’s-length business relationship with the merchant. In the same vein, processors and ISOs have successfully argued that the reserve funds themselves are not subject to the asset freeze order, because they are property of the processor or ISO, not the merchant—as evidenced by the facts that the reserve funds are typically held in the processor’s name at its acquiring bank and cannot be accessed or used by the merchant.

Joint and Several Liability Enforcement Actions. In a more extreme move, the FTC and CFPB have also named players in the payments industry as parties to litigation against untoward merchants, seeking to hold them jointly and severally liable for the *entire* amount of the consumer harm allegedly caused by a merchant’s bad acts. While there are several theories under which the government may proceed, their common undergirding principle is that the payments actor was more than just an unwitting link in the chain and instead, knowingly, or at least recklessly, assisted the merchant in perpetrating fraud on consumers. (Of course, the particular prohibited conduct varies depending on the theory of recovery.)

There is relatively little case law fleshing out these theories at present. Thus, defending against these enforcement actions may first involve legal challenges to *whether* the relief sought by the government is even available in a particular case. Nevertheless, at this stage, the strongest defenses may be largely factual. The more the processor or ISO can demonstrate diligence in screening, boarding, and monitoring merchants, the better chance it has of defeating the

government's efforts to saddle it with the entire amount of consumer harm.

In sum, although the government is increasingly aiming its scrutiny at the payments industry and testing ever more aggressive theories of recovery, there are still strong defenses to be raised. And knowing where the pressure points are and putting up a good fight, even if it does not result in an outright "win," can bring the government to the bargaining table to reach a reasonable resolution.

For more on this topic, please see:

- [A Tightening Chokehold: The FTC and CFPB Continue to Take Aim at the Payments Industry](#)¹
- [Operation "Choke Point": An Aggressive FTC and the Response of the Payment Systems Industry](#)²

¹ <http://www.electran.org/guest-analysis-a-tightening-chokehold-the-ftc-and-cfpb-continue-to-take-aim-at-the-payments-industry/>

² <http://www.electran.org/ocp/>

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