

LITIGATION – THE BIGGEST LEGAL MOVER AND SHAKER

By Paul A. Rianda, Esq.

A number of recent lawsuits have been moving and shaking the landscape of the bankcard industry. Some of these lawsuits that have been filed and are on-going have the potential to fundamentally change many aspects of our business. Below I will discuss a few of those cases and their potential impact on our industry.

Northern Leasing:

Northern Leasing is being sued in the Supreme Court of the State New York in the case of Pludeman v. Northern Leasing Systems, Inc., a case which has just been certified as a class action lawsuit. The website for the Plaintiffs' lawyer, Chittur & Associates, P.C., alleges that "Northern Leasing Systems, Inc., of New York City, [is] asserting a fraudulent scheme to entrap small businesspersons fraudulently into equipment leases with undisclosed charges and onerous terms. Plaintiffs, small businesses from all over the country, assert that Northern Leasing deceptively sells these leases to small businessmen through what appears to be a standard form one page lease, complete with signatures, and a personal guaranty. Thereafter, it routinely charges and collects much more than what is specified in the first page, and foists several other liabilities on the unsuspecting small businesses." In addition to the company, the lawsuit also seeks to recover damages from individuals associated with the company.

Leasing in the bankcard industry is much less prevalent than it was a few years ago and it appears if this and other lawsuits are successful, leasing essentially may become a thing of the past. In the "golden age" of leasing in the late 1990s early 2000s, just about every merchant's account was sold in conjunction with a lease. The company I worked for was originating 2000 or more leases a month and there were many other companies doing that same volume of business or more. This resulted in a reliance on leasing revenue to fund operations and a situation where we and many other companies really did not put much emphasis on how much we made off residuals payments.

How times have changed. Fast forward to today and leases are the exception rather than the rule. Many of the larger leasing companies have gone out of business or have substantially reduced the number of deals they originate. There are not many options today if you want to lease equipment and this Pludeman lawsuit will likely further reduce the availability of leasing, especially if the case is successful. Litigation in the industry as it relates to leases has reduced leasing opportunities to the point where pretty soon it may be nearly impossible to lease equipment any more in our industry.

Greg Daily:

One of the most notable stories of the year involved Greg Daily, one of the biggest movers and shakers in our industry. That lawsuit resulted in a considerable judgment against Mr. Daily. The plaintiff in the lawsuit one Douglass Shooker, alleged that Mr. Daily had kept Mr. Shooker from investing into a predecessor to the company that eventually became iPayment. The City Paper, a Nashville online daily, reported that Shooker was successful in obtaining a judgment in the amount of \$300 million in actual damages and \$50 million in punitive damages. Shortly after the judgment was

rendered, Mr. Daily filed for bankruptcy protection. Lawyers for Mr. Daily have indicated that they intend to file an appeal. Of note, the judgment was rendered against Mr. Daily personally and not against the company he is associated with iPayment.

Interchange Wars:

The biggest mover and shaker in our industry from a litigation perspective is the continuing litigation against the card associations related to interchange rates. This is the one area I personally see as the biggest potential threat to our industry, along with the legislative attempts to essentially set interchange rates and other fees charged to the merchants.

The premise of these lawsuits is fairly simple. Most of the cases allege some type of violation of anti-trust law in that somehow the card associations are conspiring to keep interchange rates artificially high. Essentially, in all the suits, plaintiffs want to get some form of negotiated rate for interchange or to have all interchange fees lowered.

While the cases themselves are straightforward, the impact of the lawsuits is not as simple. The one example usually cited as to the potential impact of fixing interchange rates is Australia. In that country, interchange rates were mandated that were considerable lower (approximately one half) of the rates charged in this country. That resulted in a considerable loss of income to the banks and other parties providing payment processing, money you can bet they were going to make up somewhere. In Australia, the consumers suffered the most. To make more income credit card companies drastically reduced the rewards available to consumers and also increased fees charged to consumers. So, in the end the mandated interchange rates likely did little to effect the overall economy, except shift the burden of fees from the merchants to the consumers.

If the lawsuits seeking to change the way interchange is charged went all the way to trial and resulted in some court mandated interchange rates, the impact on our industry could be significant. If all of a sudden interchange is reduced to say 1%, then how would the parties (banks, processors, ISOs, agents, etc.) know how to divide up all the revenue derived from the merchants without ripping up their existing contracts and starting all over?

The good news is that it is unlikely it would get to that. Most lawsuits end up being settled before they get to trial. In these cases, the stakes are considerable and involve two very large public companies with huge cash reserves fighting to make sure that they end out in the most favorable possible position they can. To that end, the most likely result is that the plaintiffs and the card associations will fight it out until close to the bitter end, but settle before trial. Settlements are by their very nature compromises that allow both sides some leeway and avoid an abrupt and potentially disruptive result if the case were allowed to go to trial.

While it will be interesting to see how the cases discussed above are ultimately resolved, rest assured that there will be other new lawsuits filed by enterprising plaintiffs and their attorneys that continue to challenge our business. Lawsuits will continue to move and shake our industry and impact the way we all do business.

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