

The Myth of Merchant Ownership

By Paul A. Rianda, Esq.

In my practice I constantly have agents call me and state that in their Agent Agreement they want to make sure that they “own the merchant”. There is a popular myth in this industry that an agent or other party to the merchant relationship can “own a merchant”. As explained below, no one party ever owns a merchant but instead, the merchant ownership is shared by every party that provides credit card processing services to the merchant.

Parties to the Merchant Arrangement:

In order to understand who owns a merchant, the various parties to the merchant relationship and their respective roles must be defined. People in this industry often use the term ISO to try to describe a multitude of different types of organizations in the bankcard industry. Below, I will provide some definitions of the various parties to the merchant relationship while trying to avoid the confusing term ISO.

The most powerful parties to the merchant relationship are Visa and Mastercard (and to a lesser extent American Express, Discover and the like). Visa and Mastercard are associations of member banks that are not-for-profit organizations. Visa and Mastercard promulgate rules and regulations that govern the entire relationship between a merchant and all the other parties providing credit card processing to that merchant. As such, Visa and Mastercard have overall control over the credit card transaction process, including the ability to regulate and fine member banks, credit card processors, merchants and agents.

Next in the chain below Visa and Mastercard, are the various member banks that belong to those associations. The member banks vary greatly in size and financial strength. Most member banks perform high-level underwriting for merchants and act as a conduit to allow the merchant credit card processing to occur. However, they usually do not provide the frontline customer service, chargeback and risk functions to the merchants but instead allow what I call a “Credit Card Processor” to perform those functions.

Below the banks are the various Credit Card Processors. The Credit Card Processor is usually the party that provides the frontline customer service, charge back processing and risk monitoring functions for the merchant transactions. The Credit Card Processor, the member bank and the merchant are the only parties to the merchant agreement. The Credit Card Processor is the party in the chain with the most direct contact to the merchant. However, the Credit Card Processors could not survive without the “feet on the street” sales agents that provide them with merchants. Most Credit Card Processors do not sell directly to merchants or, if they do, only have a limited sales force. Instead, they leave the sales of their products to the sales agents which can range from one person going from business to business in strip malls to large organizations acquiring hundreds of merchants per month.

Sharing the Merchants’ Residual:

Given the multiple entities set forth above that are involved with the merchant, it becomes very hard to say that one particular party “owns” the merchant. Each party in this chain has certain rights to revenue and profits derived from the merchant. Consequently, it is very difficult to say that any one party “owns” the merchant.

Visa and Mastercard, as the ultimate force behind the credit card transaction industry, have the ability to move merchants, and in fact, close down banks that are not performing adequately. Consequently, all parties are subject to Visa and Mastercard’s policies and guidelines and as such Visa and Mastercard have the ultimate say over who actually owns the merchant. Visa and Mastercard are also entitled to a certain revenue streams associated with the merchants.

As the next step in the chain, the member banks also make claims to ownership of the merchant. Although agreements between banks and Credit Card Processors may state that one party or the other owns the merchant, the banks consent is generally required to move the merchants from one bank to another. In addition, banks usually are entitled to receive a fee per merchant per month, plus a few basis points on overall merchant processing volume from the Credit Card Processor, for allowing the Credit Card Processor to be associated with the member bank. Consequently, the bank has a right to revenue under the standard agreement between the bank and the Credit Card Processor that also influences who “owns” the merchant. This revenue stream to the bank usually cannot be cut off by the Credit Card Processor without paying some kind of compensation to the bank. Hence, the bank, like all the other parties to the transaction, has an ongoing claim to ownership until and unless the agreement between the bank and the Credit Card Processor terminates or expires.

As to the Credit Card Processor, it too has the right to a certain residual stream associated with the merchant. The Credit Card Processor usually receives the bulk of the revenue derived from the merchant after payment of interchange, dues and assessments and other direct costs associated with processing of credit card transactions. However, although it receives the bulk of the revenue from merchant, the Credit Card Processor usually has to pay those funds to the sales agents that acquired the merchant initially.

For their part in providing the merchant with the Credit Card Processor, the agents are also entitled to a share of the revenue derived from the merchant. An agent can expect to receive anywhere from 50 – 70% of the total revenue that is derived by the Credit Card Processor. Also, it is becoming standard in the industry for this residual stream to continue on for the life of the merchant. Therefore, the Credit Card Processor and the sales agent remain intertwined for as long as the merchant continues to process credit card transactions.

No Ownership of the Merchant:

Now that we have defined the parties to the transaction and their various rights to residuals, it is clear that no one party can claim that they own the merchant. If a Credit Card Processor wants to move from one bank to another, first it usually must receive the consent of the bank to do so. The Credit Card Processor can move the merchants, but the Credit Card Processor must continue to pay its sales agents under its Agent Agreements. Consequently, the Credit Card Processor does not have sole ownership of the merchants even though it can move them. The Credit Processor must continue to pay

a portion of the revenue derived from the merchants to the agent so the agent also has an ownership right in the continuing residual stream from the merchant.

As to the agent, it can never be said that an agent would “own” a merchant more than any other party to the transaction. In reality, like all the other parties to the transaction, the agent owns the right to receive a residual stream under its contract with the Credit Card Processor and nothing more. However, this is the same of all other parties to the transaction including the bank, Credit Card Processor and even Visa and Mastercard. They all are sharing a certain residual stream derived from the merchant and have certain contractual duties, obligations and rights under those contracts.

All the parties to the transaction are dependent upon the other parties to allow the merchant to continue to process and also to continue to derive the revenue stream. The myth of merchant ownership is nothing but popular legend in the bankcard business.

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