

Client Alert

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Joint and Several Liability for Payment Processor That Facilitated Fraud

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On December 13, the Eleventh Circuit Court of Appeals affirmed the decision of the U.S. District Court for the Middle District of Florida finding a credit card payment processor jointly and severally liable, under a theory of aiding and abetting, for the full judgment entered against fraudulent telemarketers. *Federal Trade Commission v. WV Universal Management, LLC*, No. 6:12-cv-01618-ACC-KRS (11th Cir. Dec. 13, 2017) (hereinafter “*Appellate Opinion*”). The payment processor, Universal Processing Services of Wisconsin, LLC (“Universal”) and its then President, Derek DePuydt, did not appeal the trial court’s finding of aiding and abetting liability under the Federal Trade Commission’s (“FTC’s”) telephone sales rule (“TSR”), but challenged the amount of judgment. *Id.* at 2. While some courts have rejected efforts by the Consumer Financial Protection Bureau (“CFPB”) to establish vicarious liability for the acts of payment processors,¹ the decision provides useful guidance to payment processors as to the appropriate steps required at the merchant underwriting and monitoring phases.

FACTUAL BACKGROUND

The principal merchant defendants were found to have operated a telemarketing boiler room scheme to exact payments from consumers in exchange for fraudulent credit card interest reduction services. *Id.* at 3; *Federal Trade Commission v. HES Merchant Services Company, Inc. et al.*, No. 6:12-cv-1618-Orl-22KRS, at 1 (M.D. Fla. Oct. 26, 2016) (hereinafter “*Dist. Ct. Opinion*”). After some discovery, the FTC amended its complaint to assert claims of aiding and abetting against Universal and DePuydt under the TSR. Universal provided processing services for two accounts referred by its independent sales agent, Hal Smith. Smith had worked with Universal for more than a decade, and his referrals were so profitable that DePuydt personally reviewed and approved the merchants’ applications, glossing over “a slew of red flags” of the potential fraud risk. *Appellate Opinion* at 4, 8. The FTC alleged, and the trial court found, “that [the payment processor defendants] knew or consciously avoided knowing of the fraudulent activities [the principal merchant defendants] conducted, and that Universal substantially assisted ... in perpetrating the scheme by providing the merchant accounts.” *Id.* at 5. The trial court entered judgment of disgorgement jointly and severally against all defendants, including the payment processor, in the amount of \$1,734,972, reflecting the net amounts collected from consumers as a result of the fraud. The trial court premised the payment processor’s liability on “substantial assistance rather than on a common enterprise theory,”² finding that the processing of payments constituted “substantial assistance or support” to the actors committing fraud. *Id.* at 7, 8. The payment processor defendants challenged the joint and several liability determination, arguing that their liability should be limited to the \$410,000 in fees they received.³ *Id.* at 20. *Dist. Ct. Opinion* at 12.

¹ Please see our previous client alerts, “[CFPB Case Against Payment Processors Dismissed: Court Sanctions Bureau for Non-Responsive Discovery](#)” and “[Court Finds CFPB Case Against Payment Processor Lacking](#).”

² The FTC’s TSR provides: “It is a deceptive telemarketing act or practice and a violation of this Rule for a person to provide substantial assistance or support to any seller or telemarketer when that person knows or consciously avoids knowing that the seller or telemarketer is engaged in any act or practice that violates §§ 310.3(a), (c) or (d) [prohibiting deceptive practices], or § 310.4 [prohibiting abusive practices] of this Rule.” 16 C.F.R. § 310.3(b).

³ In total, the defendants charged consumers \$2,592,427, of which \$839,849 had been returned to consumers by way of chargebacks and another \$17,606 through returns or refunds — a chargeback rate of over 32%.

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FINDING OF JOINT AND SEVERAL LIABILITY

Both the district court and the Eleventh Circuit found that there was limited case law assessing substantial assistance liability under the TSR. Both courts looked to tort⁴ and securities law for guidance to find it within the court's discretion to hold an aider and abettor payment processor jointly and severally liable for the entire harm where a defendant "substantially assists the primary violator." *Id.* at 7, 10, 11-13. The courts' exercise of that discretion to reject the payment processor's request for apportionment of damages is undoubtedly informed by the facts of the case, including that:

- DePuydt deferred almost entirely to his sales agent Smith's referral, because Smith had long been a source of profitable referrals (*Dist. Ct. Opinion* at 6; *Appellate Opinion* at 4);
- the court found on summary judgment, and the Eleventh Circuit affirmed, that Smith was individually liable for direct violations of the FTC Act and the TSR (*Id.* at 7);
- Smith had substantial involvement with the telemarketing operation;⁵ before his involvement with the telemarketing scheme at issue, Smith owned and operated a company that telemarketed debt relief services — until the Florida Department of Agriculture shut it down (*Id.* at 5);
- DePuydt personally underwrote the applications, ignoring credit deficiencies and a "high risk fraud alert" for the principals of the business (*Appellate Opinion* at 4, *Dist. Ct. Opinion* at 6);
- DePuydt then approved the second account despite high chargeback levels flagged by MasterCard; "experts for both the FTC and the merchant testified if DePuydt had followed company protocols and ordered an investigation, the processor would not have signed up the merchants" (*Dist. Ct. Opinion* at 9); and
- Universal charged about 16 percent fees on the transactions, of which Smith received 10–12 percent (*Id.*).

The district court and the Eleventh Circuit found no reasonable basis to parse the harm caused by the payment processor and the primary fraudsters, noting that, "without its payment processing services, no money would have been stolen." *Appellate Opinion* at 16.

LESSONS FROM THE DECISION

The FTC likely will be emboldened to pursue payment processors under an aiding and abetting theory where a determination is made that telemarketing merchants commit fraud. The TSR provides for such liability. Outside of the telemarketing context, the FTC would need to assert that the payment processors actively participated in the fraudulent scheme in direct violation of FTC Act § 5, a much heavier lift. However, the Dodd-Frank Act extends

⁴ In promulgating the TSR, the FTC looked to tort and securities law aiding and abetting theories to support the rule, noting that "knowledge of, and substantial assistance to, another's wrongdoing are a sufficient basis for liability in tort." *Appellate Opinion* at 11 (quoting Telemarketing Sales Rule, 60 Fed. Reg. 43,842, 43,851 (Aug. 23, 1995)). See also Telemarketing Sales Rule, 60 Fed. Reg. 43,842, 43,851 & n.97 (invoking securities law in explaining the aiding and abetting rule).

⁵ "Smith testified that he reviewed the TYS Defendants' telemarketing scripts, sometimes required corrections, and would not write a contract for a merchant account if he was unsatisfied with the scripts. He also said he threatened to terminate the accounts if TYS Defendants hired certain people of whom Smith did not approve, and recommended that they hire a specialist to defend TYS against consumers who sought chargebacks. In addition, he testified that he kept a close eye on the TYS Defendants personally and through a surrogate by visiting the TYS premises to monitor its business practices." *Dist. Ct. Opinion* at 6.

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liability to covered persons who aid and abet consumer fraud, as do many state deceptive trade practice statutes, giving much more enforcement leeway to the CFPB and state attorneys general. *Dodd Frank Act* § 1036, 12 U.S.C. § 5536. Moreover, payment processors aren't the only financial services providers who could face liability for aiding and abetting fraud — Prudential Regulators look to banks to assure appropriate due diligence and monitoring of consumer complaints and unusual return rates.⁶ Payment processors and their sponsoring banks, therefore, need to continue to establish and follow robust underwriting and screening processes and establish procedures for ongoing monitoring of, and responding to, red flags on merchant accounts. A number of cases outline those parameters. See, e.g., *FTC v. CardFlex, Inc. et al.*, No. 3:14-cv-397-MMD-GWF (D. Nev. May 5, 2015).

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⁶ See, e.g., *Third-Party Relationships: Frequently Asked Questions*, OCC Bulletin 2017-21 (June 7, 2017), <https://www.occ.treas.gov/news-issuances/bulletins/2017/bulletin-2017-21.html>; *Bank Service Company Act* (12 U.S.C. §§ 1861-1867) (extending prudential regulation and examination authority to bank service companies).

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