2016

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National Banking Law Review, Vol. 32(5), 2013.

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Osgoode Legal Studies Research Paper No. 56
Vol. 12/ Issue. 12/ (2016)

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90 per cent of the initial principal amount of the mortgage and interest thereon; hence, only that portion of a privately insured mortgage is zero risk weighted.

8 OSFI Advisory, *Conversion to International Financial Reporting Standards (IFRSs)*, March 2010, <http://www.osfi-bsif.gc.ca/app/DocRepository/1/eng/guidelines/accounting/advisories/IFRS_e.pdf>.

9 *Ibid.*, p. 5.

10 CMHC released *The NHA Mortgage-Backed Securities Guide 2013* at the end of July 2013, <http://download.isiglobal.ca/cmhc/mbs_th/NHA_MBS_Guide_EN_Jun28_w.pdf>.

11 *Ibid.*, p. 13-3.

• THE PROCESSOR AND THE CONTRACTUAL MATRIX IN A CARD SCHEME: HOW PRIVITY FELL AND RESURRECTED IN *ALDO v. MONERIS* •

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Participants in a typical interbank[1] payment card transaction are a cardholder, a merchant, an issuing bank, and an acquirer (the merchant's bank). The issuer incurs a payment obligation, which benefits either the payee-merchant or the acquirer. The issuer and acquirer are member banks in a card network association that establishes rules and standards governing the issuance and use of the cards. Usually, a member bank both issues cards and "acquires" merchants who will accept the cards. In a given transaction, a member bank may thus act as either an issuer or acquirer (or both, in which case the transaction is not "interbank"). As elsewhere, the credit card landscape in Canada is dominated by two for-profit associations: Visa and MasterCard.

Way back in 1979, the *Goldstein Report*[2] described the operation of a multibank credit card payment as follows:

> a) a bank (card-issuing bank) issues a plastic card to a cardholder, which is linked to a predetermined line of credit and may be used in any location displaying the appropriate logo. The amount of the line of credit will depend upon a cardholder's creditworthiness;
>
> b) a cardholder signs an agreement with the issuing bank, in which that person promises to pay the bank for the purchases, including any cash advances, made during a billing period. The option of spreading out those payments over time, while paying interest, is specified therein;
>
> c) a merchant signs an agreement with its bank, in which it agrees to honour the card displaying the appropriate logo and to pay the bank a discount (a specified percentage) for each payment transaction in which the card is used;
>
> d) the merchant, at the time of sale, issues a voucher or charge slip, which the cardholder signs. When a transaction exceeds a certain variable amount of money (as determined by its bank), the merchant, depending on the system, will request an authorization number from either its or the cardholder's bank;
>
> e) the merchant's bank, in order to issue such a number, will communicate with the computer centre, of the cardholder's bank, known as the charge card division (assuming that the merchant and cardholder are customers of different banks). The cardholder's record, as it relates to that person's use of the card and the amount of credit that is outstanding, are stored in the computer system of the cardholder's bank. If there is a balance in the line of credit and/or if there are no indications of overdue or delinquent accounts, an authorization number will be issued. Often, when a cardholder has a good financial record but the line of credit has been exceeded, a bank may automatically increase that person's line of credit. When an authorization number is issued, the merchant records it on the sales voucher and the cardholder's line of credit is appropriately reduced;
>
> f) the merchant's bank processes all the vouchers, including those issued without an authorization number. Recently, some banks have started to truncate these vouchers. In other words, the voucher is retained by the merchant's bank and the relevant information on it is communicated to the cardholder's bank on a magnetic tape;
>
> g) the card-issuing bank posts the cardholders' accounts by making changes in its computer system for

> the payment transactions that were processed with and without an authorization number; and
>
> h) the banks settle by exchanging a settlement voucher and by adjusting the accounts each bank maintains with the Bank of Canada.

Since the *Goldstein Report*, the system has become substantially more automated. However, subject to enhanced automation, the basic elements of the transaction have not changed. Specific principal changes are as follows: No sales draft is "forwarded [anymore] to the member bank which originally issued the card."[3] Rather, information, on the basis of which funds are transferred and settled, is communicated exclusively electronically. Furthermore, Canada recently embraced the *Europay, MasterCard, Visa* (EMV) standard. This is an open-standard set of specifications for smart card payments and acceptance devices premised on "chip" technology for a credit card, which provides enhanced security and fraud protection. At-the-terminal authorization on an EMV credit card may be carried out by means of inserting a card and entering a PIN rather than by means of a manual signature on a sales draft. The EMV standard also accommodates *Near field communication* (NFC), enabling contactless access with and without a PIN.

At the same time, the relationships among participants in a credit card payment transaction have not changed dramatically. Its fundamentals can be summarized as follows: Each bank card issuer, while a registered user of Visa's or MasterCard's trademark, carries on the credit card business in its own name and not in partnership with other registered users or the licensor of the trade name. It may therefore sue a cardholder for amounts outstanding in his account in its name alone.[4] As well, a bank credit card issuer was characterized as a supplier of funds designed to satisfy the cardholder's indebtedness to the merchant.[5] More specifically, it was held that "payments made by [a credit card issuer] to ... merchants pursuant to [a] cardholder agreement" are not advances to merchants against their assignment of the cardholder's debts for the price of goods and services paid by card. Rather, such payments constitute "a loan of money" from the issuer to the cardholder.[6] It was also held that the acceptance by a merchant of a credit card payment constitutes an absolute discharge of the cardholder's obligation to the merchant.[7] In case of the cardholder's dissatisfaction with the merchant's performance, the acquiring bank may contractually claim vis-à-vis the merchant a right of chargeback. Such a right is available to the acquirer at its own discretion and with no obligation to investigate the cardholder's complaint.[8]

In setting out "[t]he contractual hierarchy" in the typical credit card scheme, the recent case of *Aldo Group Inc. v. Moneris Solutions Corp* [*Aldo*][9] has not challenged any of the above-stated principles and rules. Rather, in discussing the position of the card network processor in the contractual matrix, it addressed and mapped an expanded maze of contractual relationships underlying the credit card transaction. Against the background of an increased pace of automation, this aspect of the decision merits consideration irrespective of the particular issue involved in the judgment.

The role of the processor in a card network, in the context of the entire relationship map in a card arrangement, taking into account the processor's role, was described in *Aldo* as follows: The processor is responsible for the supplying of point-of-sale terminals to merchants and is acting to "connect" them to a member bank. As such, it is a party to processing contracts with merchants as well as with member banks. It is, however, not a party to each individual card payment transaction.

Separate bilateral contracts between the processor and the card association, the issuer, and the acquirer, as well as between the card association and the issuer and the acquirer, require the issuer, acquirer, and the processor to comply with the card association rules. Such rules govern the issuance and use of cards branded by the card association. As undertaken by them in their

respective agreements with the card association, member banks and processors contractually require merchants to comply with identified parts, albeit not all the association rules.

The cardholder's position was not addressed in *Aldo* but will be mentioned here for the completion of the picture. Thus, the cardholder is contractually bound to the card issuer under the credit card agreement. The cardholder is also a party to a contract with the merchant from whom the cardholder pays for the goods or services. At the same time, no contractual privity exists between the processor and the cardholder. From the cardholder's perspective the processor is an agent of either the issuing or the merchant's bank or both. As well, there is no contract between the cardholder and the acquiring bank.

Nor is there contractual privity between the cardholder and the card association. The card association is not a party to each payment transaction. Rather, it has a licence agreement with the issuing and acquiring banks that are association members. Through its bilateral contracts with the issuer, acquirer, and processors, the card association facilitates uniform standards and enhances the value of the system by maintaining as well as expanding the network so that a cardholder is able to use the card with a large number of merchants, using diverse acquirers, over a large geographic span. However, and this is again a point not addressed in *Aldo*, the cardholder is not bound to comply with the card association rules that, in fact, do not concern him directly.

By way of summary, the card association has contracts with member banks. In a card payment transaction, each such bank acts as an issuer or an acquirer or both. The card association also has a contract with the processor. The processor has its own contracts with merchants, the card association, and member banks. The acquirer is in a contractual relationship with the merchant, while the issuer is under a contract with the cardholder. Each pair of bank members does not have a specific contract, but card association rules are likely to serve as a binding contract among all of them. The cardholder and merchant are parties to the transaction for the sale of goods or services for which payment is made. As well, the card association rules bind in their entirety the issuing and acquiring bank and the processor. They bind merchants only in part and do not bind the cardholder directly.

In *Aldo*, card association rules included a choice of forum provision requiring submission to the jurisdiction of the courts of New York State. This forum selection bound member banks, the card association, and the processor among themselves. In fact, its binding effect was confirmed in the respective agreements of the banks and the processor with the card association. However, per the card association's respective agreements with the bank and the processor, this rule was not included in the part of the rules to which the merchant was bound under its own agreements. The card association argued that the merchant was nevertheless bound by this forum selection.

In the facts of the case, Aldo was a retailer of footwear. Most purchases made at its stores used credit or debit cards, including MasterCard. The latter was an incorporated card association. Moneris was a third-party processor (TPP) of payment transactions made with MasterCard credit cards at participating merchants, including Aldo. Aldo's bank in Canada was the Bank of Montreal ("BMO") that was a member bank in MasterCard. BMO was not a party to the litigation.

In April 2010, Aldo was informed by MasterCard that credit cards used to make legitimate purchases at some of its retail outlets had subsequently been used to make fraudulent purchases. An investigation concluded that Aldo's failure to comply with certain data security standards mandated by MasterCard and to which Also was bound contractually had facilitated the subsequent fraudulent use of credit card data. As a result, MasterCard imposed a financial assessment on BMO, which was passed down the contractual chain to Moneris. Moneris debited Aldo's account by the amount of the assessment—over US$4 million. Aldo sued Moneris

and MasterCard, seeking to recover the assessment, taking the position that both MasterCard and Moneris acted wrongfully in imposing and collecting the assessments. Alternatively, if its action against Moneris failed, Aldo argued it was entitled to be subrogated to the position of Moneris to assert its rights against MasterCard for wrongfully imposing and collecting the assessments. MasterCard filed a motion to stay Aldo's action, based on the contractual forum selection clause submitting to the jurisdiction of New York courts. As indicated, such a clause existed in MasterCard's contracts with member banks as well as with Moneris. It did not exist in Aldo's contract with Moneris (as well as presumably with BMO). Rather, Aldo's contract with Moneris contained a clause providing the Ontario courts with jurisdiction over contractual matters.

In support to its application for stay,

> MasterCard argue[d] that regardless of how one characterises the claims asserted by Aldo, in its Claim Aldo plead[ed] that MasterCard did not have the right to impose the Assessments on BMO and Harris pursuant to License Agreements to which Aldo is not a party. Since Aldo lack[ed] any privity of contract with MasterCard, Aldo could only have standing to assert such claims against MasterCard as an equitable subrogee of BMO [...] As an equitable subrogee of BMO [...], Aldo would be subject to all contractual rights that MasterCard has against BMO [...], including MasterCard's right to invoke the Member New York Forum Clause incorporated into the License Agreements.
>
> In addition, to the extent Aldo [had] any claim against MasterCard arising from the Assessments as an equitable subrogee of Moneris, Aldo [was] subject to all contractual rights that MasterCard has against Moneris, including MasterCard's right to invoke the Moneris New York Forum Clause in the Moneris TPP Agreement requiring that claims against MasterCard arising from Moneris' activities as processor of MasterCard Payment Card transactions for BMO [...] be litigated only in the courts of New York..[10]

In dismissing MasterCard's application for stay of proceedings, the court reasoned as follows:

1. "Since the basis of Aldo's claim against Moneris is the unlawfulness of the Assessments imposed by MasterCard," MasterCard is a necessary and proper party in Aldo's claim against Moneris with which Aldo is in privity of contract. "As well, MasterCard is a necessary party by reason of Aldo's claim that Moneris and MasterCard conspired to inflict economic harm on it."[11]
2. "Drawing on the same events Aldo asserts several direct claims against MasterCard—tort, unjust enrichment and declaratory relief." Those pleas are not "artful devices to circumvent a forum selection clause." Furthermore, "Aldo was not privy to any contract containing the New York Forum Clause, so there was no clause to which it had contracted that it had to circumvent."[12]
3. In alternatively seeking "a declaration that Aldo is subrogated to rights of Moneris and [BMO] and is entitled to assert 'causes of action' which they may have against MasterCard," at this point of time, Aldo is not seeking to enforce such rights.[13]

Accordingly, the court concluded, "the 'essential character' of the claims pleaded by Aldo is not one of equitable subrogation, but they are direct claims advanced by a stranger to the contracts to which MasterCard is privy."[14] Not being itself privy to such contracts, Aldo is not bound by the New York Forum selection clause under MasterCard's contracts with BMO and Moneris.

In the final analysis, other than as an exposition of the contractual relationships in a multiparty credit card scheme, the judgment of the court is noteworthy in two major respects that appear to be contradictory. First, notwithstanding the precise contractual network, the court had no difficulty in accommodating an action by a stranger to a contract. In fact, there is no mention in the report of a motion for dismissal on an alleged lack of a cause of action. At the same time, notwithstanding the collapse of the privity walls, it

was the map of the contractual relationships that determined whether and where the forum selection clause applied. In the facts of the case, it is the both points' accumulating effect that allowed Aldo to proceed. The broader point of relevance is the importance of contract drafting, in credit card arrangements and otherwise, even in a day and age where the sanctity of privity of contract is not strictly observed anymore.

[*Editor's note*: **Benjamin Geva**, counsel at Torys LLP, is a member of Torys' Payments and Cards Practice. He is a leading international legal expert on payment instruments and methods, bank deposits and collections, credit transactions and facilities, electronic banking, and payment and settlement systems.]

[1] Participants need not necessarily be "banks" but could be other financial institutions. They are nevertheless predominantly "banks," and in any event, the term "bank" is loosely used here to denote any financial institution participating in a credit card scheme.

[2] S. Goldstein, *Changing Times: Banking in the Electronic Age* (Government of Canada, 1979): 134–135.

[3] As was the case, for example, in *Harris Trust and Savings Bank v. McCray*, (1974), 316 NE 2d 209, 1974 Ill. App. LEXIS 2249, at 211 (Ill. App. Ct.) [*Harris*].

[4] *Price v. Bank of Montreal*, [1979] N.S.J. No. 599, 11 C.P.C. 315 (N.S.S.C. App. Div.).

[5] *Royal Bank of Canada v. Scarlato*, [1986] O.J. No. 2971, 59 C.B.R. (N.S.) 211 (Ont. Dist. Ct.).

[6] *Harris*, *supra* note 3.

[7] *Re Charge Card Services Ltd.*, [1988] 3 All E.R. 702 (CA).

[8] See, *e.g.*, *Office Furniture 4 U Ltd. v. Toronto Dominion Bank*, 2011 CarswellOnt 16052 (Ont. Sup. Ct.) (WLeC).

[9] [2012] O.J. No. 1931, 2012 ONSC 2581 at paras. 10–25 and is further discussed throughout the judgment [*Aldo*].

[10] *Ibid.*, paras. 35–36.

[11] *Ibid.*, para. 80.

[12] *Ibid.*, para. 81.

[13] *Ibid.*, paras. 82–83.

[14] *Ibid.*, para. 85.

• BLUEHEDGE INVESTMENTS: A LESSON IN FINANCIAL LITERACY •

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Central 1 Credit Union

Introduction

When I was a month away from finishing my law degree, a strange announcement appeared on the school bulletin board: a financial literacy seminar. As a soon-to-be graduate, I imagined that someone with my level of education and financial savvy would not need to bother with such basics. However, my curiosity got the better of me and I attended. The seminar was instructed by a representative from one of the major Canadian banks in a room surprisingly packed with my peers. During the seminar, I was hit with a realization most likely feared by all law school grads: lack of knowledge. The discussion topics ranged from debt management to personal investment options. While the mounting debt for graduating students was easier to grasp, I also realized that despite taking a slew of corporate law classes, many still struggled with interpreting a balance sheet and had vague ideas about obtaining investor disclosure and the complexity of investment options. Some of this knowledge came later as part of my practice. But for many of my peers who chose to focus on other areas of law, this knowledge most likely never came. Yet, lawyers (of all stripes) are assumed to be sufficiently savvy to make complex investment decisions and are often targeted by various types of investment opportunities including fraudulent ones.

November is a financial literacy month across the country, and the focus of regulators is not to educate only the public but also those who serve them. Much can be said on the matter of financial literacy; however, as lawyers, we often feel our knowledge is sufficient to avoid fraud and recognize a "Bernie Madoff." Moreover, those of us who work as legal counsel for major