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New York Supreme Court Rules that Merchant Lacks Standing to Sue MasterCard over Data Security Breach Assessments; All Merchants Left in Peril as a Result if MasterCard Unlawfully Imposes Data Breach Assessments

On May 5, the Commercial Division of the New York Supreme Court for Westchester County dismissed the complaint in *Jetro Holdings, LLC v. MasterCard International, Inc.*, in which Jetro, a leading food service wholesaler, had sued to recover approximately \$6 million in fees and assessments imposed by MasterCard in the wake of data security breaches suffered by Jetro.

The fees and assessments at issue had been collected by MasterCard in the first instance from Jetro's acquirer/processor PNC Bank ("PNC"), and in turn indemnified by Jetro. In dismissing Jetro's complaint, the court rejected Jetro's argument that Jetro, as PNC's indemnitor, should be equitably subrogated to the rights of PNC to recover from MasterCard the fees and assessments in question, on the ground that MasterCard had violated both its own rules and New York law in imposing and collecting those fees and assessments. The court also rejected Jetro's alternative argument that Jetro had valid claims in its own right against MasterCard that entitled Jetro to recover the fees and assessments by reason of MasterCard's unlawful actions in collecting them. The decision's denial of any right of action by Jetro against MasterCard under these circumstances puts all merchants at extreme peril, because if the *Jetro* court's ruling is upheld on appeal or followed by other courts in similar cases against MasterCard, all merchants will be essentially defenseless in the event MasterCard unlawfully imposes assessments arising out of data security breaches, unless they have included language in their acquirer/processor agreements either absolving themselves of any liability, or granting themselves an assignment of the acquirer/processor's claims against MasterCard, were MasterCard to act unlawfully in imposing such assessments.

Jetro entered into a contract with PNC under which PNC agreed to serve as Jetro's "acquiring bank" within the MasterCard network, meaning that PNC would authorize Jetro to accept MasterCard-branded cards in its stores and process transactions made with those cards. In return, Jetro agreed to pay PNC an interchange fee; to comply with MasterCard's rules for payment card network members as set forth in MasterCard's *Standards*; and to indemnify PNC against any fines and assessments that MasterCard might impose. PNC, in turn, contracted with MasterCard to serve as an acquiring bank in the MasterCard payment network, and to comply with the *Standards*. The *Standards* state that an alleged data security breach at a merchant like Jetro constitutes an Account Data Compromise Event ("ADC Event") when it results, directly or indirectly, in the unauthorized access to or disclosure of payment card account data. Upon determining in its sole discretion that a breach constitutes an ADC Event, MasterCard then unilaterally calculates what it deems to be fraud losses and operational expenses incurred by MasterCard issuers as a result of the breach, and collects assessments for those losses, plus additional fines, from the merchant's acquirer/processor (here, PNC).

The basis for Jetro's complaint stems from two incidents in 2011 and 2012 in which cybercriminals breached Jetro's computer network, and inserted malware into Jetro's system that attempted to capture payment card data. After each incident occurred, MasterCard unilaterally determined that an ADC Event had taken place and unilaterally determined what losses it deemed its credit card issuers to have suffered as a result of the event. MasterCard's

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agreement was with PNC, not Jetro, so MasterCard collected from PNC both a case management fee and monetary assessments equal to the amount of the issuers' supposed losses, as unilaterally determined by MasterCard. PNC then invoked the indemnity clause in its contract with Jetro, and withheld from funds that were otherwise due to Jetro the fees and assessments that MasterCard had collected from PNC. Jetro then brought suit against MasterCard to recoup these amounts.

In its complaint, Jetro alleged that MasterCard violated its own *Standards* in imposing and collecting the fees and assessments in question, by concluding that the incidents in 2011 and 2012 constituted ADC Events even though it lacked evidence that any payment card data was stolen in these incidents, and by imposing fines and assessments even though it lacked evidence that MasterCard issuers suffered any losses as a result of these incidents. Jetro further alleged that MasterCard violated New York law in imposing and collecting the fees and assessments, because the MasterCard *Standards* are not valid liquidated damages provisions under New York law and as a result the fees and assessments were unenforceable contractual penalties. Although Jetro was not in contractual privity with MasterCard, Jetro argued that it should be equitably subrogated to the contractual rights of PNC to seek recovery of the fees and assessments from MasterCard on the ground that MasterCard acted unlawfully and without authority in imposing and collecting them. In the alternative, Jetro asserted claims in its own right directly against MasterCard seeking recovery of the fees and assessments, arguing that MasterCard's unlawful collection of the fees and assessments constituted unjust enrichment, and that by unlawfully levying these fines and assessments MasterCard had obtained money that in equity and good conscience belonged to Jetro.

In ruling on MasterCard's motion to dismiss the complaint, the court agreed with Jetro that the doctrine of equitable subrogation in New York extends beyond the scope of insurance law, and encompasses "every instance in which one party pays a debt for another for which another is primarily answerable, and which in equity and good conscience should have been discharged by the latter." However, it found that the equitable subrogation standard was not met, because MasterCard was not answerable to Jetro for the payments of the fees and assessments, notwithstanding the fact that MasterCard imposed the fees and assessments based entirely on Jetro's conduct and having dictated to PNC the terms of the agreement between PNC and Jetro and with constructive knowledge that Jetro would be required to indemnify PNC in full for MasterCard's unlawful actions. The court held that, because cybercriminals allegedly stole the payment card data that formed the basis for MasterCard's unilateral determination of the amounts to collect from PNC and make discretionary payments to issuers, MasterCard could not be deemed responsible for the damages incurred by Jetro based on MasterCard's alleged unlawful actions. The court similarly dismissed Jetro's direct unjust enrichment claims, finding that Jetro did not directly convey any benefit on MasterCard as any funds that MasterCard received were obtained directly from PNC as a result of the MasterCard/PNC agreement.

Were the court's opinion to be upheld on appeal (Jetro filed a notice of appeal on May 24, 2016), and/or followed by other courts in similar cases against MasterCard, it would leave a merchant essentially defenseless against any and all unlawful actions MasterCard may take in imposing an issuer reimbursement assessment based on the merchant's having suffered a data security incident, no matter how egregious MasterCard's actions may be, unless the merchant's agreement with its acquirer/processor absolves the merchant of any obligation to indemnify or reimburse the acquirer/processor for, or grants the merchant an assignment of the acquirer/processor's right to recover, were MasterCard to act unlawfully in imposing any such assessment. The *Jetro* court found nothing inequitable about Jetro's being forced to bear the fees and assessments at issue, even though Jetro's complaint alleged and the court's opinion did not dispute that MasterCard acted in direct violation of both its own rules and New York law in imposing and collecting those assessments. On the logic of the court's opinion, then, MasterCard could allegedly impose any issuer reimbursement assessment that strikes its fancy following a data security breach, in any amount that MasterCard may unilaterally choose and in direct violation of both its own rules and New York law, and a merchant that has agreed to indemnify its acquirer/processor against such an invalid and unlawful assessment and has not gotten an assignment of the acquirer/processor's claim to recover that assessment is helpless to do anything about MasterCard's alleged unlawful actions.

The *Jetro* court's ruling and analysis appears to be inconsistent with New York equitable subrogation law, as one would think that, where Party A has blatantly violated both its contract with Party B and applicable law in collecting

an amount from Party B, that would paradigmatically be a case where “equity and good conscience” would call for subrogating Party B’s indemnitor to Party’s B’s rights to recover the unlawfully collected money from Party A. The court’s ruling on Jetro’s direct claims found that MasterCard could not be unjustly enriched at Jetro’s expense, because MasterCard received the fees and assessments directly from PNC, rather than Jetro. However, this reasoning is at odds with NY law, which does *not* require a direct flow of funds from the plaintiff to the defendant but rather only that the relationship is not too attenuated. Here, MasterCard’s contract with PNC exists solely to facilitate transactions between MasterCard and Jetro and, in particular, MasterCard imposed the fees and assessments based on conduct by Jetro. The ruling is also inconsistent with how other courts have addressed similar claims. In *Genesco v. Visa*, the Middle District of Tennessee agreed, based on facts indistinguishable from those alleged by Jetro, that a merchant could assert common-law claims directly against Visa for unlawfully imposing fines and assessments consequent to a data breach. Similarly, in *Aldo Group Inc. v. Moneris Solutions Corp.* the Court of Appeal for Ontario allowed Aldo to sue MasterCard directly, finding on facts indistinguishable from those alleged by Jetro that Aldo could directly assert causes of action including unjust enrichment.

The *Jetro* court’s ruling is thus vulnerable to challenge both on appeal and in other similar cases brought against MasterCard in other courts. But the ruling should not be ignored, because of the perilous position all merchants will be in if the ruling is either upheld on appeal or followed in other cases. In order to protect against this peril, every merchant should carefully review its acquirer/processor contract to make sure that it either absolves the merchant of any obligation to indemnify or reimburse its acquirer/processor for any unlawfully imposed MasterCard assessment or (as was the case in *Genesco*) grants the merchant an assignment of the acquirer/processor’s claims to recover any such assessment from MasterCard. In addition, every merchant should carefully review its insurance policies to ensure that they provide adequate coverage were MasterCard to unlawfully impose assessments. Otherwise, the merchant would be left helpless if MasterCard acts unlawfully in imposing fines, fees, and/or assessments when the merchant is unfortunate enough to suffer a data security breach.

Ropes & Gray is representing Jetro in this lawsuit. For more information regarding the *Jetro* decision or to discuss data security practices generally, please feel free to contact [Heather Egan Sussman](#), [Doug Meal](#), [Jim DeGraw](#), [Seth Harrington](#), [David McIntosh](#), [Mark Szpak](#), [Michelle Visser](#), [Laura Hoey](#), [Marc Berger](#), [David Cohen](#), or another member of Ropes & Gray’s leading [privacy & data security](#) team.