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JANUARY 23, 2018 | HOLLI TARGAN

The Third Stark Lesson: ISO Liable Under TSR For All Merchant Fraud Damages

On December 13, 2017, the United States Court of Appeals for the Eleventh Circuit held that an independent sales organization can be held liable for all damages suffered by consumers as a result of a merchant's violation of the Telemarketing Sales Rule ("TSR"). The court rejected the ISO's argument that its liability should be limited to the fees it received from the merchants as a result of the merchants' processing activities.

We previously reported on this case when the action was first filed by the FTC, back in 2013. The complaint alleged that Newtek Merchant Solutions, the ISO, and its President, violated the TSR. The TSR provides that it is a deceptive telemarketing act, and a violation, for a person to provide substantial assistance or support to any telemarketer when that person knows or consciously avoids knowing that the telemarketer is engaged in a deceptive telemarketing act, as defined in the regulation.

Lesson One: An officer of an ISO may be held personally liable for violations of the TSR.

The FTC maintained that Newtek's payment processing services enabled the charges on consumers' card accounts to clear through the card networks and that without the ISO's assistance, it would have been impossible for the merchant to charge consumers fees for its deceptive interest rate reduction services. Further, Newtek allegedly knew that many of the merchants' accounts were connected to operations that were likely engaged in fraud. The underlying scheme involved the merchants' promises that they would reduce the interest rates on consumers' credit cards if they paid between \$600 – \$1,000 to the merchants. The scheme generated more than \$2.5 million in credit card payments.

According to the Court, "despite several glaring red flags" including an unusually high number of chargebacks, the ISO opened one and then a second merchant account. In a previous action, the FTC prevailed against the ISO and its President in holding them liable for the fraud perpetrated by the merchants.

Lesson Two: An ISO may be liable under the TSR for the fraud perpetrated by one of its merchants. Be careful who you agree to process for.

The issue in the December action was the amount of the damages to be awarded against the ISO.

The Court of Appeals held that "a violation of the TSR's substantial assistance rule can support joint and several liabilities to the extent of the unjust gains." It rejected the ISO's argument that damages should be apportioned between the defendants or that the ISO should only be obligated to disgorge the amount of the fees the ISO retained from processing credit card transactions.

Lesson Three: An ISO may be liable for all damages incurred as a result of its fraudulent merchant.

This opinion appears to be the first of its kind interpreting the liability provisions of the TSR as applied to ISOs. It is a wake-up call that ISOs must listen to in order to avoid potential exposure far exceeding the number of processing revenues.

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