UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

LONE STAR NATIONAL BANK, N.A., *et al*.,	§	
	§	CASE NO. 10cv00171
Plaintiffs,	§	
vs.	§	
	§	
KEYBANK NATIONAL ASSOCIATION, *et al*.,	§	JUDGE LEE H. ROSENTHAL
	§	
Defendants.	§	

DEFENDANT KEYBANK NATIONAL ASSOCIATION'S REPLY BRIEF IN SUPPORT OF ITS FED.R.CIV.P. 12(b)(6) MOTION TO DISMISS

Plaintiffs' claims against KeyBank National Association ("KeyBank") should be dismissed in their entirety. Plaintiffs fail to establish that they are intended beneficiaries of the contract between KeyBank and Heartland Payment Systems ("HPS"). Plaintiffs further fail to show that the economic loss rule is inapplicable to their claims or that this Court should create a common-law duty on the part of KeyBank outside of the recovery mechanisms provided within the framework of the Visa and MasterCard payment card networks.

I. THERE IS NO THIRD-PARTY BENEFICIARY CLAIM

Plaintiffs allege that they are third-party beneficiaries to the Merchant Processing Agreement ("MPA") between KeyBank and HPS. Based on this allegation, they assert a breach of contract claim. But in their opposition brief, as in their complaint, Plaintiffs fail to identify *any* provision of the MPA that *KeyBank* breached. The only MPA provision Plaintiffs cited in their opposition is the provision stating that *HPS* is to safeguard data it receives "relating to

KeyBank business[.]"[1] (Opp. at 16, quoting MPA at ¶ 4.3(b).) But this provision creates no obligation on *KeyBank's* part, and thus cannot be reasonably read to create some intended benefit running *from KeyBank to anyone*—much less to any or all of the issuers within the Visa and MasterCard networks.

Recognizing that the MPA itself does not provide any basis for a third-party beneficiary claim against KeyBank, Plaintiffs are forced to rely on the obligations that KeyBank purportedly undertook as a member of the Visa and MasterCard networks. (Opp. at 15, citing Compl. ¶¶ 2, 7, 119.) In making this claim, Plaintiffs must concede that it is the Visa and MasterCard rules and regulations—which govern the networks—that form the basis for their claim that KeyBank owes them a third-party benefit. But, as explained in KeyBank's opening brief, those rules and regulations explicitly disclaim any third-party rights. (Br. at 6.) And Plaintiffs do not dispute this fact. Plaintiffs cannot have it both ways. They cannot seek to enforce as third-party beneficiaries obligations allegedly arising from the networks' regulations, but at the same time escape the plain language of the regulations that explicitly disclaim such third-party rights.

Plaintiffs contend that such an argument is a "red herring" because they are relying on the MPA for their breach of contract claim, which does not contain such an explicit disclaimer. (Opp. at 16.) But it is undisputed that the MPA incorporates Visa and MasterCard's rules and regulations—including the disclaimer of third-party beneficiary rights—into the terms of the MPA and gives those rules precedence over the MPA's terms.[2] (MPA at 1.1(i).) Moreover, Plaintiffs have done nothing to refute the data-breach cases in which courts held that the

[1] As discussed in KeyBank's opening brief (Br. at 8), Plaintiffs' complaint only identifies MPA provisions imposing duties on *HPS* and not KeyBank. (*See* Compl., ¶ 118 (citing MPA at 1.1(e), 1.2(e), 4.3(b), 4.5(a)).)

[2] *See In re National Century Financial Enterprises, Inc.*, No. 08-4216, 2010 WL 1976639, at *7 (6th Cir. May 18, 2010) (noting that "Ohio courts look to the language of the contract to determine if a party is a direct or incidental beneficiary").

disclaimer language contained in the Visa and Mastercard networks' rules and regulations precluded an issuer's third-party beneficiary claim when incorporated into the underlying merchant agreement. (*See* Br. at 6-7, *discussing In re TJX Cos. Retail Sec. Breach Litig.*, 564 F.3d 489, 499 (1st Cir. 2009), *aff'g* 524 F. Supp. 2d 83, 90 (D. Mass. 2007); *CUMIS Ins. Soc'y, Inc. v. BJ's Wholesale Club, Inc.*, 455 Mass. 458, 464-69 (Mass. 2009).)

II. PLAINTIFFS HAVE NOT ESTABLISHED A FIDUCIARY DUTY CLAIM

Plaintiffs assert a breach of fiduciary duty claim. But Plaintiffs do not claim that they stand in a traditional fiduciary relationship with KeyBank. Instead, Plaintiffs rest their fiduciary duty claim solely on the unsupported allegation that card-network members are all part of a "joint venture." (Opp. at 24-30.) Plaintiffs attempt to manufacture a fiduciary duty out of the network regulations (imposed by *contract*, not by operation of *law*) despite the fact that network members compete against one another for business in the payment card industry.

Plaintiffs have done nothing to distinguish or question the *Nabanco* court's finding that the Visa card network "exhibits characteristics of a joint venture, [but] is not technically a 'joint venture.'" *National Bancard Corp. v. Visa U.S.A., Inc.*, 779 F.2d 592, 601 (11th Cir. 1986) ("*Nabanco*"). Plaintiffs argue that the interchange fee system somehow comprises "agreements to make profits" within a "joint venture." (Opp. at 26). But as the *First Data* and *Nabanco* courts noted, the profits and fees from payment card transactions are not *shared* or brought under the "mattress" of the network as a whole. *First Data Corp v. Visa U.S.A., Inc.*, No. C-02-01786, 2006 WL 516662, at *4; *Nabanco*, 779 F.2d at 601. Simply put, the networks facilitate and govern payment card transactions, but they are not joint ventures.

Even if the networks could be legally classified as joint ventures, Plaintiffs cannot possibly argue that KeyBank's alleged duty to monitor HPS (a duty purportedly imposed by the network regulations) arises by operation of law as a fiduciary duty between sophisticated

financial institutions. Plaintiffs attempt to dismiss the importance of the *First Data* case because it involved a "single entity" determination. (Opp. at 30). But Plaintiffs cannot avoid the fact that the *First Data* court explicitly held that issuing banks and acquiring banks—many of which perform both functions—do not maintain fiduciary duties to protect one another's economic interests in light of their constant self-dealing and direct competition with one another in the processing industry. *First Data*, 2006 WL 516662, at *6; *see also Nabanco*, 779 F.2d at 601 ("Each member also competes vigorously against other members in a variety of ways.").

III. PLAINTIFFS HAVE NO VIABLE TORT CLAIMS FOR NEGLIGENCE OR VICARIOUS LIABILITY

Plaintiffs do not dispute that under Texas or Ohio law, their tort claims fail. Moreover, Plaintiffs fail to rebut the cases in which courts have rejected other issuers' attempts to recover in tort from acquirers following a data breach.[3] Rather, Plaintiffs argue that this Court should not make a choice of law decision in ruling on KeyBank's motion to dismiss and that their claims would survive if the Court applied New Jersey law in this case. This argument has no merit.

A. New Jersey Law Does Not Apply

Here, the Court need not look beyond the pleadings to determine the law that should apply in this case. Plaintiffs have explicitly alleged that KeyBank is an Ohio resident and that "[p]art of the events and/or omissions giving rise to the Plaintiffs' claims have occurred and/or originated in the Southern District of Texas." (Compl. ¶23.) Thus, Plaintiffs' own allegations support application of Texas or Ohio law, both of which operate to bar Plaintiffs' tort claims.

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[3] *See In re TJX Companies Retail Security Breach Litigation*, 564 F.3d 489, 498-99 (1st Cir. 2009) (affirming dismissal of issuer's negligence claim against acquirer); *CUMIS Ins. Soc'y, Inc. v. BJ's Wholesale Club, Inc.*, 23 Mass. L. Rptr. 550, at ** 8-9 (Mass. Super. 2005) (same); *Pa. State Employees Credit Union v. Fifth Third Bank*, 398 F. Supp. 2d 317, 326 (M.D. Pa. 2005) (same); *Sovereign Bank v. BJ's Wholesale Club, Inc.*, 533 F.3d 162, 179-80 (3rd Cir. 2008) (affirming district court's dismissal of tort claims against merchant and acquiring bank).

Nevertheless, Plaintiffs assert in their opposition brief that, because HPS is headquartered in New Jersey, it is "entirely likely" that the wrongful conduct occurred in New Jersey and therefore New Jersey law could apply in this case. (Opp. at 35.) But Plaintiffs have made no factual allegations in their complaint to support this claim, nor have they alleged in the complaint that New Jersey has any connection to this case. Indeed, New Jersey is not mentioned even once in the 158 paragraphs of the complaint. Such a pleading deficiency is, in and of itself, sufficient grounds to dismiss Plaintiffs' tort claims. *See Berry v. Indianapolis Life Ins. Co.*, 608 F. Supp. 2d 785, 800 n.16 (N.D. Tex. 2009) ("A complaint should be dismissed when the governing law cannot be determined from the facts alleged therein.") (*citing Enigma Holdings v. Gemplus Int'l. S.A.,* No. 3:05-cv-01168-B, 2006 WL 2859369, at *7 (N.D. Tex. Oct. 6, 2006)).

Had Plaintiffs wanted New Jersey law to apply in this case, they should have, at the very least, pleaded some facts that would support its application. Instead, Plaintiffs plead that the acts or omissions giving rise to this case took place in Texas. Plaintiffs cannot now switch course in opposition to KeyBank's motion to dismiss because Texas law does not support their claims.[4]

B. Tort Claims Fail Even Under New Jersey Law

Even applying New Jersey law—Plaintiffs' only proposed alternative—the economic loss rule bars Plaintiffs' claims against KeyBank. *See Spring Motors Distributors, Inc. v. Ford Motor Co. et al.*, 98 N.J. 555, 579-582 (N.J. 1985) (adopting economic loss doctrine in New Jersey).

The plaintiff in *Spring Motors* was a truck dealer that purchased trucks from Ford and specifically requested them to be installed with Clark transmissions. *Id.* at 562. After

[4] Plaintiffs also ignore the significance of the MDL Panel's decision to centralize the various cases against HPS—including eleven cases that originated in New Jersey and seven that originated in Texas (such as Lone Star's case against HPS)—in this District. Reviewing the same operative facts, the Panel found that "various plaintiffs maintain that discovery related to the data breach will be found in the Southern District of Texas." Case No. 4:09-md-2046, Docket Entry 1, filed June 10, 2009.

experiencing problems with the transmissions, Spring Motors sued Ford and Clark for breach of warranty, strict liability, and negligence seeking damages for economic loss. *Id*. at 564. The court held that recovery for economic loss was only available through contract law and that the plaintiff's tort claims were barred.[5] *Id.* at 578. In so holding, the court stated that tort law was designed to address unforeseen physical injury claims where contract law was meant to address "claims for consequential damages that the parties have, or could have, addressed in their agreement." *Id.* at 579-580.

Thus, if other avenues of recovery are available, a party cannot bring a tort claim against another party for pure economic loss.[6] *See Dynalectric Co. v. Westinghouse Electric Corp.*, 803 F.Supp. 985, 990-991 (D.N.J. 1992). In *Dynalectric*, a sub-subcontractor brought a negligence action against both the general contractor and a sub-contractor for economic losses due to construction delays. *Id.* at 986-988. The court applied New Jersey law and held that "if a party is able to pursue remedies in another way, for instance, if the claims can be characterized as contract claims * * * it may not supplement its claims with allegations of negligence." *Id.* at 990. The court concluded that, Dynalectric could not maintain a tort claim separate from its contract claim against the sub-contractor and therefore, Dynalectric's negligence claims were barred even against the general contractor, with whom Dynalectric was not in privity. *Id.* at 993.

New Jersey has recognized that in certain cases purely economic losses may be recovered as damages in tort. *See People Express Airlines, Inc. v. Consolidated Rail Corporation*, 100 N.J.

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[5] *See also Travelers Indemnity Co. v. Dammann & Co*., 594 F.3d 238, 248 (3d Cir. 2010) ("[I]n keeping with the purpose of the economic loss doctrine, New Jersey courts have consistently held that contract law is better suited to resolve disputes between parties where a plaintiff alleges direct and consequential losses that were within the contemplation of sophisticated business entities with equal bargaining power and that could have been the subject of their negotiations.").

[6] *See also Titan Stone, Tile & Masonry, Inc. v. Hunt Construction Group, Inc.*, 2007 WL 174710 (D.N.J. Jan. 22, 2007) (applying New Jersey law and dismissing fraud and conversion claims flowing from an alleged contract breach).

246, 267 (N.J. 1985). In *People Express*, on which Plaintiffs rely, an airline company brought a negligence action against a rail company for releasing toxic chemicals into the air and causing a fire a mile away from the Newark Airport. *Id.* at 249. The fire forced the airline to shut down its terminal for 12 hours, resulting in solely economic loss. *Id.* at 249-250. Because the court determined that the rail company should have foreseen that negligent handling of toxic chemicals on its rails would cause nearby businesses to evacuate, the court allowed the airline to recover its economic losses in tort. *Id*. at 263.

Unlike the sub-subcontractor in *Dynalectric*, who was given an opportunity to seek redress under the various parties' contracts, the airline in *People Express* had no alternative avenue for recovery. *See Dynalectric*, 803 F.Supp. at 990-91. In allowing the airline's tort claim to survive, the *People Express* court did not establish an absolute right to tort recovery of economic losses, but rather left open the possibility of recovery in tort where no other available channels of recovery exist. *See id.* at 991.

People Express is distinguishable from this case, which more closely resembles *Spring Motors* and *Dynalectric*. Plaintiffs, which are sophisticated financial institutions, bargained for (or could have bargained for) protection against losses in connection with payment card processing by virtue of their contracts with Visa and Mastercard. Even though KeyBank owes no direct or third-party contractual obligation to Plaintiffs, this case arises out of the parties' performance in the Visa and Mastercard networks. Those networks are governed by rules and regulations that regulate and provide redress for their respective members.

Under New Jersey law, as under Ohio and Texas law, Plaintiffs' tort claims (for negligence and vicarious liability) are barred by the economic loss doctrine. Plaintiffs have contracts with the card networks and are subject to the networks' rules and regulations, which

provide detailed mechanisms for allocating risk and compensating losses in connection with payment card transactions. Compl. ¶¶ 26, 33. Plaintiffs have a means of recovering their economic losses, but instead improperly recast their purely economic claims as tort claims against KeyBank.

C. New Jersey Law Does Not Recognize The Common-Law Duty Claimed By Plaintiffs

Plaintiffs urge the Court to recognize a New Jersey common-law duty of care from KeyBank, as an acquirer in the payment card networks, to Plaintiffs, as issuers in the networks, in regard to monitoring HPS's activities. (*See* Compl. ¶ 131.) But Plaintiffs have failed to cite a case in New Jersey or anywhere else declaring that such a duty exists. In fact, the only court to address this question held that no such duty exists, and dismissed negligence claims identical to the claims asserted by Plaintiffs here. *See Cumis Ins. Soc'y, Inc. v. Merrick Bank Corp.*, No. 07-374, 2008 WL 4277877, at *11-12 (D. Ariz. Sept. 18, 2008). Plaintiffs fail to refute, distinguish, or even address, this case in their opposition brief.

Whether a common-law duty exists is a "matter of law properly decided by the court[.]" *Wang v. Allstate Ins. Co.*, 592 A.2d 527, 534 (N.J. 1991). Where, as here, there is an absence of guidance from the state courts on an issue of state law, the Court must attempt "to predict state law, not create or modify it." *See Rx. Com Inc. v. Hartford Fire Ins. Co.*, 364 F. Supp. 2d 609, 613 (S.D. Tex. 2005) (Rosenthal, J.).

Without pleading any factual support, Plaintiffs claim that New Jersey law may apply in this case. Plaintiffs argue that, under New Jersey law, this Court should recognize a common-law duty on KeyBank's part. In making this argument, Plaintiffs concede that the foreseeability of damages to Plaintiffs resulting from the data breach is not dispositive of the question of duty, and that fairness and policy considerations govern whether the imposition of a duty is warranted.

(Opp. at 40.)

Recognizing that there are other considerations beyond foreseeability, Plaintiffs nevertheless fail to establish why fairness and policy considerations would compel this Court to create the common-law duty they seek. Plaintiffs do not dispute that the Visa and MasterCard rules and regulations create a comprehensive system for protecting the interests of the networks' members. (*See* Br. at 17, discussing these rules.) Nor do Plaintiffs dispute that the networks' rules and regulations protect them from damages arising from a data breach by creating comprehensive recovery mechanisms. Thus, Plaintiffs must present this Court with a reason why in this case, where Plaintiffs have already taken steps to protect their interests, fairness and policy considerations would compel creation of an additional common-law duty to protect those same interests. Plaintiffs have failed to do this.

In short, Plaintiffs have not shown why New Jersey law would recognize a common-law duty in a case where the class of persons the duty would benefit has the ability to protect itself against the risk. Because of this failure, Plaintiffs' common-law negligence and vicarious liability claims fail as a matter of law and should be dismissed. *See, e.g., Piscitelli v. Classic Residence by Hyatt*, 973 A.2d 948, 967 (N.J. Super. Ct. App. Div. 2009) (finding that employer owed plaintiff no duty to detect theft of her identity by employee, emphasizing that she was in position to protect against risk herself and other remedies existed in the field); *Cross v. County of Essex*, 2007 WL 208531, at *2 (N.J. Super. Ct. App. Div. Jan. 29, 2007) (in determining whether a duty exists, "[a] related question is whether plaintiff lacked the ability or opportunity to avoid the harm.").

CONCLUSION

For the foregoing reasons and the reasons set forth in KeyBank's opening brief, Plaintiffs' claims against KeyBank should be denied with prejudice. [7]

Respectfully submitted,

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[7] To the extent not raised in this Reply, KeyBank incorporates the arguments raised and applicable authority cited by Heartland Bank in its Reply.

CERTIFICATE OF SERVICE

I hereby certify that on June 7, 2010, a copy of the foregoing was filed electronically. Notice of this filing will be sent to counsel for all parties by operation of the Court's electronic filing system. Parties may access this filing through the Court's system.

/s/ James A. Slater
One of the attorneys for KeyBank National Association