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Vantiv: A Closer Look at Company's Merchant Agreement; Agreement Contains Potentially Illegal Early Termination Provision

Legal Update

The terms and conditions of the merchant processing agreement used by Vantiv contain a liquidated damages provision that requires merchants to pay potentially enormous sums of money to terminate their relationship with the company. Sources in the industry indicate that this provision can and does limit the ability of merchants to switch to other payment processing companies.

Legal experts we spoke to for this article claim that the provision is likely illegal and unenforceable under most state laws. However, Vantiv's agreement also contains a mandatory arbitration provision that could allow the company to attempt to enforce the provision against merchants without going into state and federal courts.

Nonetheless, merchants and other industry sources tell us that Vantiv generally does not attempt to enforce this provision against merchants who push back against it, and our search revealed no legal proceedings in which Vantiv attempted to collect this fee against a recalcitrant customer. If Vantiv's practice of backing off from collecting the fee when challenged becomes more widely known, that could result in more merchants switching away from the company and to another provider.

Liquidated Damages Provision

Section 7(b) of Vantiv's merchant processing agreement states: "If we terminate this Agreement after a breach by you, or if you terminate this Agreement before the end of the Initial Term or any Renewal Term, you agree to pay an early termination fee of an amount equal to the greater of: (i) $495.00 per location, and (ii*) the average monthly fees assessed to you under the Agreement for months during which you processed any transactions (exclusive of interchange fees and other fees or assessments imposed by a third party in connection with your payment processing) multiplied by the number of months remaining in the then-current Initial Term or Renewal Term, as applicable*" (emphasis added).

Under this term, a cancelling merchant is required to pay Vantiv an early termination fee equal to the average monthly fee it has paid so far during the contract, multiplied by the remaining months on the contract. So, for instance, if a merchant had a 36-month contract, paid an average of $1,000 per month for the first six months, and then switched to a new payment processing company, that merchant would be required to pay $30,000 ($1,000 times 30 months) to Vantiv.

This is what is known as a liquidated damages provision, and its legal purpose is to ensure that the non-breaching party, in this case Vantiv, receives compensation approximately equal to the actual damages it suffers from a contractual breach. Under most state law, the amount of compensation provided for in a liquidated damages clause must be a reasonable estimate of the actual damages. Such a provision cannot function as a penalty or punishment.

We described this clause to law professor Nancy S. Kim and asked her whether she thought it was lawful. She replied that "it sounds punitive" and "doesn't sound like a legitimate use of a liquidated damages clause to [her]." Kim elaborated: "It looks like a deterrent. They are trying to prevent people from leaving."

The proper estimate of damages for a clause like this should, according to Kim, be whatever it costs Vantiv to onboard a new merchant. This way, if a merchant cancels the agreement shortly after it begins, Vantiv is able to recover its upfront costs and avoid any financial loss. Vantiv's estimate of damages, which is the entire contract price, cannot possibly be calibrated to serve this purpose.

Other Payment Processors

When reached for comment, a Vantiv spokesperson explained: "Early termination fees are standard not only in the payments processing industry, but in many other industries as well. The fees represent foregone revenue when a merchant exits a contract prior to the expiration of the term of the agreement."

Of the six payment processors we looked into for this story, only Global Payments had an early termination fee that was calculated in a way similar to Vantiv. Others, such as Chase, Worldpay, and FirstData, appear only to require that merchants settle up for any processing services already provided and return any equipment already received. Some competitors, like Wells Fargo, do have an early termination fee, but it is a flat rate like $500 that is much more likely a reasonable estimate of the loss suffered by the company in the event of an early termination.

Legal Consequences

The immediate legal consequences of using an unlawful liquidated damages provision are only that the clause would be unenforceable in state court. That is, its illegality would be a defense to a lawsuit brought by Vantiv against a merchant, but could not be the basis for a suit by merchants against Vantiv.

Vantiv's merchant agreement contains a mandatory arbitration provision that would allow Vantiv to attempt to collect this fee through a private arbitral proceeding rather than in a state court. Arbitral proceedings are not necessarily bound by state laws concerning the unenforceability of particular contractual provisions, and it is therefore conceivable that Vantiv could attempt to enforce the liquidated damages through this private judicial mechanism.

Practical Consequences

Merchants and industry competitors that we spoke to indicate that, in practice, Vantiv does not attempt to enforce its liquidated damages provision against merchants that resist paying it. One source told us that it was not uncommon for switching merchants he is familiar with to write a letter to a state attorney general in order to get Vantiv to back off their attempt to collect the fee. We also could not find any legal proceedings in which such an enforcement attempt was made.

When faced with the prospect of paying such an enormous early termination fee, merchants generally respond in one of the following ways:

1. **Stay with Vantiv.** Since most people do not realize that the fee is not actually enforced by Vantiv, they believe they must pay it if they switch. And since any savings they could achieve through switching would be outweighed by having to pay out their entire Vantiv contract price, they decide to stay with Vantiv.

2. **Pay a monthly minimum to Vantiv.** In some cases, clever merchants will switch to a competitor and stop processing payments through Vantiv for the remainder of their contract. This means that they will continue to

pay fixed fees Vantiv charges each month but will no longer have to pay transaction-based fees. Where the savings from switching are greater than cost of the monthly minimum fees paid to Vantiv, this makes business sense.

3. **Leave without paying.** Bolder merchants, often assisted by a payment processing consultant or a competitor, will leave and refuse to pay the early termination fee, banking on the likelihood that Vantiv will not or cannot enforce it.

The practical risk to Vantiv is that it could become more widely known, for instance on merchant payment review sites, that it does not or cannot enforce its liquidated damages provision. This would reduce the number of people who stay with the company merely to avoid paying the enormous early termination fee.