IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

IN RE: HEARTLAND PAYMENT SYSTEMS, INC. CUSTOMER DATA SECURITY BREACH LITIGATION	§ § § §	**4:10-CV-00171** **MDL NO. 2046**
(This document related to Financial Institution Track Actions)	§ § §	**HON. LEE H. ROSENTHAL**
LONE STAR NATIONAL BANK, N.A., et al. **v.** **KEYBANK N.A., and HEARTLAND BANK,**	§ § § § § § § §	**CLASS ACTION** **JURY TRIAL DEMANDED**

FINANCIAL INSTITUTION PLAINTIFFS' MEMORANDUM OF LAW IN OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS

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PRELIMINARY STATEMENT

This extraordinary case involves the largest security lapse in the history of credit card and debit card processing in the United States (the "Data Breach").

At all relevant times, Defendants KeyBank, N.A. ("KeyBank") and Heartland Bank[1] selected and contracted with Heartland Payment Systems, Inc. ("HPS") to serve as their agent in providing various credit card and debit card (together, "Payment Cards") transaction processing and related services through the Visa/MasterCard Networks.[2] Pursuant to these contracts, HPS provided risk management, front-end and back-end processing, and merchant charge-back services on behalf of Defendants. HPS, as Defendants' agent, processed retail transactions utilizing Payment Cards issued by Plaintiffs and the putative Class of financial institutions (collectively, the "FIs" or "Issuers").

As HPS' principals and "sponsors" into the Visa/MasterCard Networks, Defendants were obligated to their fellow Visa/MasterCard Network members—including FIs—to protect confidential personal and financial information contained in the Payment Cards ("Confidential Payment Card Data") by monitoring, auditing, overseeing and confirming safeguards in HPS's Payment Card processing system. As discussed in more detail below, Defendants failed to do so, which resulted in the theft of Confidential Payment Card Data from over 130,000,000 Payment Cards (hereafter, the "Data Breach").

The Data Breach occurred because Defendants failed to discover and act upon the fact that HPS' management—through reckless cost-cutting and an unbridled desire to grow profits as

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[1] Other than as described below and in the Complaint, Heartland Bank is not affiliated with HPS.

[2] KeyBank and Heartland Bank filed separate motions to dismiss. *See* Dkt. #s 26 and 28. Rather than filing separate responses to each motion, FIs file this single response to both. KeyBank's memorandum in support of its motion will be referred to as the "KeyBank Memo" and Heartland Bank's memorandum in support of its motion shall be referred to as the "Heartland Memo."

quickly as possible by minimizing expenses, including the expense of securing its Payment Card processing systems—made conscious decisions that effectively provided anyone with minimal technical savvy easy access to the Confidential Payment Card Data with which HPS was entrusted. Not surprisingly, HPS' security lapse, which was completely overlooked by Defendants, was quickly exploited by those who troll for such vulnerable computer systems.

HPS and Defendants did little to determine what the hackers were actually doing. Remarkably, the hackers went undetected for over a year. During that time, Defendants' failure to monitor, oversee and ensure that HPS had adequate internal security measures in place allowed the hackers to repeatedly breach the HPS Payment Card processing system and obtain Confidential Payment Card Data. The failure to find and expel the hackers, and Defendants' failure to ensure that HPS had adequate security measures in the first place, ultimately resulted in the Data Breach.

HPS and Defendants, however, did not suffer the *billions* of dollars in expenses associated with canceling and re-issuing the Payment Cards compromised by the Data Breach. Rather, these expenses fell on the Payment Card Issuers—*i.e.*, the FIs.

Defendants argue in their motions to dismiss that they are not responsible for any of the foreseeable financial havoc they wreaked on the FIs through their failure to oversee HPS. As discussed in greater detail below, Defendants' arguments are unpersuasive.

FACTUAL OVERVIEW

FIs are financial institutions located throughout the United States. FIs are members of the Visa and MasterCard Associations (or Networks). In their role as "Issuers" within the Visa/MasterCard Networks, FIs issue Payment Cards to consumers. FIs also may serve as "Acquirers" within the Visa/MasterCard Networks, acquiring merchants for the Visa/MasterCard Networks that accept Payment Cards in payment for retail transactions.

Defendants, like FIs, are members of the Visa/MasterCard Networks. Defendants are believed to be both Issuers and Acquirers. At all relevant times, Defendants maintained (and continue to maintain) Payment Card processing programs, pursuant to which Defendants provide transaction processing and related services for merchants that accept Payment Cards.

The Visa/MasterCard Networks are legal "associations" of members. By agreement and by conduct, each Network is a joint venture undertaken by its member financial institutions for the mutual benefit of all of the respective Network members. In each Network, the members combine their property, money, skills and knowledge in a community of interest and with a common purpose.

As Issuers, FIs must necessarily rely on the Acquirers, such as Defendants, to properly carry out their duty to protect consumers' Confidential Payment Card Data. Defendants are fully aware that the failure to protect this information will directly cause financial loss to FIs who must absorb the resulting fraudulent charges on their customers' accounts, as well bear the expense of re-issuing compromised Payment Cards.

In this regard, the applicable Federal Deposit Insurance Corporation's ("FDIC") standard of care charges Acquirers with (i) maintaining suitable controls over every third-party relationship Acquirers enter into to further Acquirers' contractual obligations, (ii) employing proper due diligence to identify and select third-party entities with which to contract, (iii) maintaining comprehensive, written contracts between Acquirers and third parties, and (iv) employing ongoing oversight of third parties and their activities. Guidance provided by the FDIC clearly states that the Visa/MasterCard Network bylaws, operating rules and regulations make their members fully responsible for the actions of all third-party entities with which they contract, and further emphasizes that Acquirers are responsible for ensuring that Payment Card activities are conducted in a safe and sound manner when employing third-party entities to perform any portion of the Payment Card processing functions.

At all relevant times, Defendants selected and contracted with HPS, a publicly traded third-party payment processing company, to serve as their agent to provide various Payment Card processing and related services on the Visa/MasterCard Networks. HPS claims to be the fifth largest Payment Card processing company in the United States and the ninth largest Payment Card processing company in the world. Pursuant to these contracts—known in the industry as Merchant Processing Agreements ("MPAs")—HPS provided risk management, front-end and back-end processing and merchant charge-back services on behalf of Defendants on the Visa/MasterCard Networks. HPS, as Defendants' agent, processed retail transactions utilizing Payment Cards issued by FIs.

At all relevant times, Defendants also contracted with HPS to serve as their agent to provide them with "Acquirer" services. As Defendants' *de facto* Acquirer, HPS, among other things, performed the initial underwriting to determine a merchant's eligibility to participate in, and process transactions through, the Visa/MasterCard Networks.

Although not a financial institution, HPS is "sponsored" into the Visa/MasterCard Networks by Defendants, its principals. Defendants' "sponsorship" provides HPS, their agent, with full access to the Visa/MasterCard Networks. For example, as stated in HPS' SEC filings, Defendants' sponsorship allows it to:

> [R]oute Visa and MasterCard transactions under [KeyBank's] control and identification numbers to clear credit bank card transactions through Visa and MasterCard . . . [that] enables [HPS] to settle funds between the cardholders and merchants by delivering funds to [KeyBank], which in turn transfers settlement funds to the merchants' bank accounts.

In connection with providing Payment Card processing services, HPS comes into the possession of—and is entrusted with—confidential personal and financial information of millions of consumers conducting business with Defendants' merchant customers (*i.e.*, the Confidential

Payment Card Data). Pursuant to its sponsored admission into the Visa/MasterCard Networks, therefore, HPS was (and continues to be) obligated to the other Visa/MasterCard Network members—including FIs—to implement, utilize and maintain the appropriate Payment Card processing system safeguards in order to protect Confidential Payment Card Data.

As HPS' "sponsors" and principals, Defendants are obligated to their fellow Visa/MasterCard Network members—including FIs—to protect Confidential Payment Card Data by monitoring, auditing, overseeing, and confirming that Heartland's Payment Card processing system safeguards are (i) in place, adequate and fully operational, (ii) in compliance with all applicable laws and FDIC guidance, and (iii) properly monitored, managed and maintained.

During the Data Breach, which commenced in late December 2007, unauthorized persons accessed Heartland's unsecure Payment Card processing system via an SQL ("Structured Query Language") injection and obtained Confidential Payment Card Data associated with approximately 130,000,000 Payment Cards. The Data Breach resulted from, among other things, (i) cost-cutting and cost avoidance decisions by HPS' management pertaining to HPS' Payment Card processing system that effectively allowed anyone with a little technical savvy easy access to the Confidential Payment Card Data, and (ii) Defendants' failure to properly monitor, audit, oversee and confirm the propriety, adequacy and effectiveness of HPS' Payment Card processing system safeguards.

Once HPS' Payment Card processing system was accessed by the intruders, HPS, which quickly received notice of the Data Breach, and Defendants, who knew or should have known that HPS' system safeguards had failed, did little to determine what the intruders were doing or how long the intrusion would continue. As it turns out, the intrusion continued for more than a year undetected by HPS or Defendants..

The combination of a lack of security in the HPS Payment Card processing system and startlingly poor IT oversight in general, coupled with Defendants' complete and utter disregard of their obligations to the Visa/MasterCard Network members to oversee HPS, their agent, allowed the intruders to access the HPS Payment Card processing system on multiple occasions and remove Confidential Payment Card Data. HPS finally disclosed the Data Breach to the public on January 20, 2009, in a carefully timed statement issued during the fanfare of President Obama's inauguration.

The Confidential Payment Card Data compromised by the Data Breach includes data from Payment Cards issued by FIs. As a direct result of the Data Breach, FIs cancelled compromised Payment Cards and issued replacement Payment Cards, incurring substantial costs in the process. FIs also absorbed a substantial amount of unauthorized charges before being notified of the Data Breach and cancelling the compromised Payment Cards. FIs' damages are the foreseeable result of Defendants' total abdication of their responsibility and duty to properly monitor, audit, oversee, and confirm the propriety, adequacy and effectiveness of HPS' Payment Card processing system safeguards.

As a direct result of the Data Breach, HPS was removed from the list of security compliant Payment Card processing companies. As a direct result of the failure to carry out their oversight obligations, Defendants were fined by Visa ($780,000) and MasterCard ($7,100,868). Per § 5 of the HPS/Visa Optional Alternative Recovery Settlement Agreement, the fine paid by Defendants to Visa was contributed to partially fund the settlement, which was consummated in early 2010. Per § 6.1 of the HPS/MasterCard Alternative Recovery Offer Settlement Agreement, which was announced May 19, 2010, of the $7,100 868 fine paid by Defendants to MasterCard, $6,600,868 will be used to partially fund the settlement.

Instead of actually addressing the injuries to FIs and other affected Issuers resulting from their wrongful actions and/or inaction, Defendants and HPS have turned a blind eye to the situation. FIs bring this class action on behalf of themselves and all similarly situated banks, credit unions and other financial intuitions that were injured by the Data Breach caused by Defendants' failure to monitor, audit, oversee and confirm the propriety, adequacy and effectiveness of Heartland's Payment Card processing system safeguards.

SUMMARY OF THE ARGUMENTS

By virtue of Heartland Bank's request that this case be transferred to this Court as part of MDL 2046, as well as the alleged wrongful actions of Heartland Bank's agent, HPS, in Texas, this Court has personal jurisdiction over Heartland Bank.

FIs state viable claims for breach of contract as intended third-party beneficiaries. A duty to the FIs was created when Defendants entered into the MPAs with HPS. The MPAs are intended to provide a direct benefit to all members of the Visa/MasterCard networks—including FIs. Under the agreements, Defendants were obligated to, *inter alia*, monitor, audit, oversee and confirm that HPS's Payment Card processing system was adequate and complied with all applicable laws and security guidance. Defendants failed to take the appropriate and necessary actions to ensure HPS instituted adequate safeguards over the Confidential Payment Card Data contained on the Payment Cards issued by the FIs that was entrusted to Defendants and HPS for processing Payment Card transactions. As a result, Payment Cards issued by the FIs were compromised.

Defendants' breach of their oversight obligations directly and/or proximately caused FIs to incur substantial costs to re-issue Payment Cards compromised by the Data Breach, as well as absorb fraudulent charges made to the compromised Payment Cards. Under these circumstances, the FIs are members of an identifiable class that Defendants should have reasonably foreseen were likely to be injured by their wrongful actions and/or inaction.

FIs also state plausible claims for breach of fiduciary duty under the applicable pleading standard.[3] Reaching well beyond the mere recitation of each claim's elements, the Complaint contains detailed factual allegations demonstrating Defendants' alleged misconduct. In short, the Complaint includes sufficient factual content from which the Court can draw the reasonable inference that Defendants are liable for the injuries suffered by the FIs. *Twombly* and *Iqbal* require no more.

Simply stated, Defendants owed fiduciary duties to FIs as a result of the joint venture formed between FIs and Defendants in the form of the Visa/MasterCard Networks. FIs allege that they and Defendants are members of the Visa/MasterCard Networks, thereby creating a joint venture relationship for the purpose of processing Payment Card transactions. Through, *inter alia*, joint membership in the Visa/MasterCard Networks, entrusting Defendants and their agent, HPS, with Confidential Payment Card Data, and Payment Card transaction processing, the elements of a joint venture are established, including intent, control and agreement on the sharing of revenues and profits. Defendants' reliance on the economic loss rule to avoid responsibility for the Data Breach, which generally applies to *tort* claims, is unavailing.

Defendants' cursory invitation to engage in a premature choice-of-law analysis with respect to FIs' tort claims should be rejected. Indeed, Defendants request the Court to consider unchecked "facts" outside of the Complaint to resolve a fact driven inquiry that should not be undertaken at this stage of the litigation prior to discovery. At this point, the Court should apply New Jersey law to FIs' tort claims, which not only has the strongest connection to the conduct at issue, but also has a strong interest in ensuring Defendants' proper oversight of HPS.

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[3] As used herein, the term "Compl." shall refer to the Complaint filed in this case against KeyBank and Heartland Bank on January 19, 2010.

Finally, Defendants are vicariously liable for HPS' negligence because at all relevant times, HPS served as Defendants' agent. Defendants allowed HPS to act on their behalf through the MPAs, yet simultaneously failed to properly supervise HPS to ensure that adequate security measures protecting HPS' Payment Card processing system were in place. Defendants also are vicariously liable for HPS' negligence because at all relevant times, HPS acted within the scope of the authority given to it by Defendants. HPS' negligence—exacerbated by Defendants' wrongful actions and/or inaction—directly and/or proximately caused FIs' injuries.

ARGUMENTS AND AUTHORITIES

I. THIS COURT HAS PERSONAL JURISDICTION OVER HEARTLAND BANK

A. Notwithstanding its request to be included in MDL 2046 and its agreement to subject itself to the jurisdiction of the Court, Heartland Bank now seeks dismissal of this case for an alleged lack of personal jurisdiction

This action was filed in the Southern District of Texas on January 19, 2010. It is a tag-along case to MDL 2046, *In re Heartland Payment Sys. Customer Data Sec. Breach Litig.*, which was assigned to this Court by the MDL Panel.

On March 2, 2010, all Parties—including Heartland Bank—filed a joint motion requesting assignment of this case to MDL 2046 (Dkt. # 20), which was granted by the Court on March 4, 2010 (Dkt. # 22 and Dkt. # 72 in Case No. 4:09-md-02046).

Notwithstanding its request to be included in MDL 2046 and subjecting itself to the jurisdiction of this Court, Heartland Bank now seeks dismissal pursuant to Rule 12(b)(2) for an alleged lack of personal jurisdiction. Heartland Bank Memo. at 2-5.

In a good faith effort to pare down the dismissal briefing, as late as May 19, 2010, FIs offered to stipulate to the following:

> [C]ounsel for the Plaintiffs and Heartland Bank believe that ... the action against Heartland Bank is already included in the MDL 2046 proceedings. As a result, Heartland Bank has agreed to abandon the arguments made in its motion to dismiss with respect to

> this Court's purported lack of personal jurisdiction over Plaintiffs' claims. This withdrawal is without prejudice to it [Heartland Bank] arguing that this Court lacks personal jurisdiction over it for any trial proceedings. See 28 U.S.C. § 1407(a) (referring to the transfer of related cases to a single forum for coordinated or consolidated "pretrial proceedings."). In turn, Plaintiffs also reserve the right to argue that this Court has sufficient personal jurisdiction over Heartland Bank to permit it to preside over any subsequent trial proceedings.

Heartland Bank, however, rejected FIs' proposal.

Heartland Bank's position is pointless and clearly a delay tactic. Assuming *arguendo* that Heartland Bank has a valid argument regarding this Court's alleged lack of personal jurisdiction, the net result would be that the case would be dismissed, FIs would re-file the case in a different federal court, FIs would then file a tag-along motion with the MDL Panel (which Heartland Bank could not oppose because of its earlier request to be included in MDL 2046), and the MDL Panel would transfer the case back to this Court as part of MDL 2046 several months from now.[4]

That said, and notwithstanding Heartland Bank's position, this Court has personal jurisdiction over Heartland Bank independent of MDL 2046 per the following analysis.

B. This Court has personal jurisdiction over Heartland Bank

A federal court sitting in diversity must satisfy two requirements to exercise personal jurisdiction over a nonresident defendant. First, the forum state's long-arm statute must confer personal jurisdiction. *Seiferth v. Helicopteros Atuneros, Inc.*, 472 F.3d 266, 271 (5th Cir. 2006) (citation omitted). Second, the exercise of jurisdiction must not exceed the boundaries of the Due Process Clause of the Fourteenth Amendment. *Id.* Because the Texas long-arm statute

[4] FIs further assert that by its conduct—*i.e.*, requesting to be included in MDL 2046 and subjecting itself to the jurisdiction of the Court—Heartland Bank waived its right to assert the lack of personal jurisdiction defense. *See, e.g., PaineWebber Inc. v. Chase Manhattan Private Bank (Switz.),* 260 F.3d 453, 460 (5th Cir. 2001) ("[A] party may waive any jurisdictional objections if its conduct does 'not reflect a continuing objection to the power of the court to act over [its] person.' ").

confers jurisdiction to the full extent of due process, the only inquiry requiring attention here is whether exercising personal jurisdiction over Heartland Bank would violate due process. *Fielding v. Hubert Burda Media, Inc.*, 415 F.3d 419, 424-25 (5th Cir.2005).

The Due Process Clause "operates to limit the power of a State to assert *in personam* jurisdiction over a nonresident defendant." *Helicopteros Nacionales de Colombia, S.A. v. Hall,* 466 U.S. 408, 413-14 (1984). The "constitutional touchstone" of the inquiry is whether the defendant "purposefully established minimum contacts in the forum State." *Asahi Metal Ind. Co. v.Super. Ct.,* 480 U.S. 102, 108-09 (1987) (quoting *Burger King Corp. v. Rudzewicz,* 471 U.S. 462, 474 (1985)).

Personal jurisdiction can be general or specific. If a defendant's contacts with the forum state are "continuous and systematic," a court may exercise general jurisdiction over any action brought against that defendant, regardless of whether the action is related to the forum contacts. *Helicopteros,* 466 U.S. at 414-15. If a defendant has relatively few contacts, a court may still exercise specific jurisdiction "in a suit arising out of or related to the defendant's contacts with the forum." *Id.* at 414 and n. 8. In fact, a single act by a defendant that is directed toward the forum state giving rise to a plaintiff's claims canbe sufficient to support a finding of minimum contacts. *Wien Air Alaska, Inc. v. Brandt*, 195 F.3d 208, 211 (5th Cir. 1999).

The Fifth Circuit has articulated a three-step analysis for the specific jurisdiction inquiry:

> (1) whether the defendant has minimum contacts with the forum state, *i.e.,* whether it purposely directed its activities toward the forum state or purposefully availed itself of the privileges of conducting activities there; (2) whether the plaintiff's cause of action arises out of or results from the defendant's forum-related contacts; and (3) whether the exercise of personal jurisdiction is fair and reasonable.

Seiferth, 472 F.3d at 271 (citing *Nuovo Pignone, SpA v. STORMAN ASIA M/V,* 310 F.3d 374, 378 (5th Cir.2002)). If a plaintiff satisfies the first two prongs, "the burden shifts to the defendant to defeat jurisdiction by showing that its exercise would be unfair or unreasonable." *Nuovo Pignone, SpA*, 310 F.3d at 382.

Here, the Court has general jurisdiction over Heartland Bank. At all relevant times, Heartland Bank contracted with HPS for HPS to serve as its agent to provide various Payment Card transaction processing and related services on the Visa/MasterCard Networks.[5] HPS could not function within the Networks on a national basis—including within Texas—without the sponsorship of Heartland Bank (and KeyBank). Compl. at ¶ 62. Heartland Bank specifically gave HPS access to the Networks "to route Visa and MasterCard under [Heartland Bank's] control []" to process Payment Card transactions. *Id.* Heartland Bank also contracted with HPS to serve as its *de facto* Acquirer on a national basis. Compl. at ¶ 4. Thus, at all relevant times, HPS served as Heartland Bank's agent and acted within the scope of the agency when processing Payment Card transactions for Heartland Bank moving into and out of Texas on behalf of Texas merchants acquired for Heartland Bank by HPS and/or receiving and possessing Confidential Payment Card Data moving into and out of Texas. *Id.* ¶ 60.

Pursuant to the Heartland Bank/HPS MPA, HPS also served (and continues to serve) as Heartland Bank's agent to provide various risk management, front-end and back-end processing and merchant charge back services for transactions moving into and out of Texas. Compl. at ¶¶ 3; 57; 60; Minton Affidavit (Heartland Bank Memo., Ex A).

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[5] To show that the acts of an agent may subject its principal to jurisdiction in a particular forum, a plaintiff must make a *prima facie* case that the agent acted with actual or apparent authority of the principal. *Product Promotions, Inc. v. Cousteau*, 495 F.2d 483, 492-93 (5th Cir. 1974). The actions by a defendant's agent—such as HPS—can establish sufficient minimum contacts to assert personal jurisdiction over the defendant principal; in this case, Heartland Bank. *See, e.g., 50-Off Stores v. Banque Paribas (Suisse) S.A.*, 1996 U.S. Dist. LEXIS 21258, *9 (S.D. Tex. 1996) (*citing Pesaplastic, C.A. v. Cincinnati Milacron Co.*, 750 F.2d 1516 (11th Cir.1985); *Delray Beach Aviation Corp. v. Mooney Aircraft, Inc.*, 332 F.2d 135 (5th Cir.1964)). Such is the case here.

Moreover, according to HPS' motion for transfer filed with the MDL Panel, Texas allegedly is the principal location for HPS' Payment Card transaction processing system. *See* MDL 2046, Dkt. # 1 at 5. As alleged by HPS, Texas is where the Data Breach occurred—which, in turn, allegedly may have given rise to FIs' claims. As HPS' principal and Network sponsor, Heartland Bank was obligated to "monitor, audit, oversee and confirm that HPS' Payment Card processing system safeguards are adequate, comply with all applicable laws and guidance, are in place, are being properly monitored, managed, updated and maintained, and are fully operational." Compl. ¶¶ 7, 119. Presumably whatever Heartland Bank did to fulfill its obligations was done in Texas.

This clearly is not a case where Heartland Bank is being haled into court as a result of the random or fortuitous acts of a third party. *Surety Bank, N.A. v. Greenway Ins. Agency*, No. 4:97-CV-723-A, 1997 WL 756562, at *3 (N.D. Tex. November 20, 1997). Heartland Bank's "continuous and systematic" contacts with Texas through the Visa/MasterCard Networks and through its agent, HPS, are more than sufficient to support the Court's general jurisdiction over Heartland Bank. Alternatively, the Court has specific jurisdiction over Heartland Bank because all three prongs of the jurisdictional inquiry are met.[6]

Heartland Bank's Rule 12(b)(2) motion to dismiss, therefore, should be denied.

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[6] The final prong of the due process analysis is whether exercise of jurisdiction over the nonresident defendant would comport with traditional notions of fair play and substantial justice. *Internat'l Shoe Co. v. Washington,* 326 U.S. 310, 316 (1945). In making this determination, the Court must look to the following factors: (i) burden on the defendant, (ii) interests of the forum state, (iii) plaintiff's interest in obtaining relief, (iv) the interstate judicial system's interest in obtaining the most efficient resolution of controversies, and (v) shared interest of the several states in furthering fundamental substantive social policies. *Asahi Metal Indus.,* 480 U.S. at 113. These factors further demonstrate that the exercise of jurisdiction over Heartland Bank by this Court is constitutionally permissible.

II. FIs PROPERLY PLEAD BREACH OF CONTRACT

A. FIs properly allege a breach of contract claim against KeyBank

FIs allege that they are intended third-party beneficiaries of the MPA between KeyBank and HPS (the "KeyBank/HPS MPA"). Compl. at ¶ 118. FIs further allege that the KeyBank/HPS MPA requires KeyBank to:

> [M]onitor, audit, oversee and confirm that Heartland's Payment Card processing system safeguards were adequate and complied with all applicable laws and guidance, were in place, were being properly monitored, managed, updated and maintained and were fully operational in order to protect the Confidential Payment Card Data of the customers of Plaintiffs and the members of the proposed Issuer Class and the Proposed Acquirer Class.

Id. at ¶ 119.

FIs explain that KeyBank breached the KeyBank/HPS MPA by "failing to monitor, audit, oversee and confirm that HPS's Payment Card processing system safeguards were adequate and complied with all applicable laws and guidance, were in place, were being properly monitored, managed, updated and maintained and were fully operational[.]" Compl. at ¶ 121. FIs assert that KeyBank's breach of the KeyBank/HPS MPA directly and/or proximately caused them to incur substantial damages, *e.g.*, "the costs to cancel and destroy compromised Payment Cards, the costs to issue replacement Payment Cards to their customers affected by the Data Breach and the absorption of fraudulent charges made on the compromised Payment Cards." *Id.* at ¶ 122.

In response, KeyBank argues that FIs fail to allege facts under Ohio law that would support a finding that FIs are intended third-party beneficiaries of the KeyBank/HPS MPA. KeyBank further argues that any duty on its part to monitor HPS arises out of the Visa/MasterCard regulations, which specifically disclaim any intent to benefit third parties. Neither argument, however, supports dismissal here.

FIs agree that Ohio law applies to their breach of contract claim (and this claim only).[7] Under Ohio law, a party need not be named in a contract to have third-party beneficiary status. *See, e.g., Hines v. Amole*, 448 N.E.2d 473, 479 (Ohio Ct. App. 1980). Rather, "[i]t is sufficient if the third person is in the contemplation of the parties." *Id.*

Thus, a party may maintain a breach of contract action if it is an intended third-party beneficiary of the contract even though it is not a named party to the contract. *ThorWorks Indus. v. E. I. DuPont De Nemours Co.*, 606 F. Supp.2d 691, 695 (N.D. Ohio 2008) (citing *Sagraves v. Lab One Inc..*, No. 06-4554, 2008 WL 162931, at *4–5 (6th Cir. 2008); *Randleman v. Fidelity Nat'l Title Ins. Co*, 465 F. Supp.2d 812, 818 (N.D. Ohio 2006)). That said, a putative third-party beneficiary must establish that the contracting parties intended to directly or primarily benefit it, and the contract satisfies a duty owed by the promisee to the third party. *Sony Elec., Inc. v. Grass Valley Group, Inc.*, No. C-010133, 2002 WL 440749, at *3 (Ohio Ct. App. Mar. 22, 2002); *Grothaus v. Warner*, No. 08AP-115, 2008 WL 4712816, at *4 (Ohio Ct. App. Oct. 28, 2008).

Here, the KeyBank/HPS MPA is clearly intended to provide a direct benefit to all members of the Visa/MasterCard Networks—including FIs. The Visa/MasterCard Networks were established "for the mutual benefit of all the[ir] members" (Compl. at ¶ 26), including the FIs as Payment Card Issuers. As a member of the Visa/MasterCard Networks, KeyBank undertook the duty and obligation to its fellow Visa/MasterCard Network members—including FIs—to maintain the confidentiality of Confidential Payment Card Data. Compl. at ¶¶ 2, 7, 119.

[7] Texas law recognizes and gives effect to contractual choice of law clauses. *In re J.D. Edwards World Solutions*, 87 S.W.3d 546, 549 (Tex. 2002). Here, the KeyBank/HPS MPA provides that "the rights and obligations of the parties hereunder shall be performed, construed and interpreted in accordance with the laws of the United States and the State of Ohio, notwithstanding any conflict of laws doctrine." *See* First Amendment Agreement at ¶ B(4). Thus, KeyBank is correct in stating that Ohio law governs Count I, at least as it pertains to KeyBank.

Upon entering into the KeyBank/HPS MPA, KeyBank became HPS' principal and sponsor, thereby enabling HPS to perform services within the Visa/MasterCard Networks. As alleged by FIs, KeyBank contracted with HPS to serve as KeyBank's agent to provide various services relating to credit card merchant processing programs, including risk management, front-end and back-end processing, and merchant charge backs. Compl. at ¶ 3.

As such, HPS undertook an obligation to fulfill KeyBank's duty to Visa/MasterCard Network members—including FIs—to secure the Confidential Payment Card Data. The KeyBank/HPS MPA specifies that HPS is to "safeguard, and hold confidential from disclosure to unauthorized persons, all data relating to KeyBank business received by [HPS] pursuant to this Agreement[.]" *See id.* at ¶ 4.3(b). By allowing HPS access to such information, KeyBank—as HPS' principal—was (and continues to be) responsible for HPS' compliance, which redounds, as logically anticipated, to the benefit of all Visa/MasterCard Network members, including FIs.

Clearly, then, the KeyBank/HPS MPA recognizes KeyBank's duty to Visa/MasterCard Network members to maintain the security of the Confidential Payment Card Data in order to prevent damage to Network members. Equally as important, by engaging HPS to fulfill this basic duty, KeyBank took on the additional duty to monitor the performance of HPS, its agent. Thus, one of the primary purposes of the KeyBank/HPS MPA is to bestow a direct benefit on FIs, as well as to fulfill KeyBank's duty of confidence owed to FIs.

KeyBank also seeks dismissal of FIs' breach of contract claim by arguing that the Visa/MasterCard regulations specifically disclaim any intent to benefit third parties. *See* KeyBank Memo. at 6. KeyBank's argument, however, is a red herring because the KeyBank/HPS MPA, the contract on which FIs rely (and on which their breach of contract claim against KeyBank is based) does not contain any such disclaimer. The same is true for the Heartland Bank/HPS MPA (*see* §(B), *infra*). This simple premise is underscored by the fact that even though the parties have amended the KeyBank/HPS MPA over time, they specifically did not include a disclaimer provision—either explicitly or implicitly—sedate the fact that they had "full knowledge of the developing body of third party beneficiary case law in the Payment Card processing arena." Compl. at ¶ 118.

FIs properly allege that they are intended third-party beneficiaries of the KeyBank/HPS MPA. KeyBank's motion to dismiss FIs' breach of contract claim, therefore, should be denied.

B. FIs properly allege a breach of contract claim against Heartland Bank

FIs also are intended third-party beneficiaries of the Heartland Bank/HPS MPA. Heartland Bank, however conveniently overlooks the relevant contract provisions implicating such liability. Heartland Bank also takes a selectively myopic view of what constitutes an intended third-party beneficiary under Missouri law.[8]

Pursuant to the Heartland Bank/HPS MPA—which is very similar to the KeyBank/HPS MPA—HPS served (and continues to serve) as Heartland Bank's agent to provide various risk management, front-end and back-end processing and merchant charge backs. Compl. at ¶¶ 3, 57, 60; Minton Affidavit (Heartland Bank Memo., Ex A). Heartland Bank, therefore, also was (and continues to be) HPS's sponsor and principal, which obligated Heartland Bank to "monitor, audit, oversee and confirm that HPS's Payment Card processing system safeguards are adequate, comply with all applicable laws and guidance, are in place, are being properly monitored, managed, updated and maintained, and are fully operational" which, in turn, protects FIs as fellow members of the Visa/MasterCard Networks. Compl. at ¶¶ 7, 119.

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[8] FIs agree that Missouri law applies to their breach of contract claim against Heartland Bank and, under Missouri law, only an intended (as opposed to incidental) third-party beneficiary has standing to enforce a contract to which it is not a party.

The Heartland Bank/HPS MPA refers to (and incorporates) the Visa/MasterCard bylaws and regulations. Minton Affidavit at §1.1(f, h); § 4.5(a). Heartland Bank knew that HPS was not in compliance with applicable guidelines that existed to ensure the safety of its operations and avoid the Data Breach. Compl. at ¶¶ 96–98, 100. This alone was a breach of the Heartland Bank/HPS MPA. Heartland Bank also breached the Heartland Bank/HPS MPA by, *inter alia*, failing to adequately safeguard the Confidential Payment Card Data and failing to properly and adequately monitor HPS. Compl. at ¶ 121. In fact, Heartland Bank was fined by Visa and MasterCard because it failed to properly perform its oversight responsibilities as the sponsor and principal of HPS. *Id.* at ¶ 13.

The Heartland Bank/HPS MPA is clearly intended to benefit third parties; specifically, FIs and other Visa/MasterCard Network members. For example, under the heading, "Confidentiality," the Heartland Bank/HPS MPA requires both parties to take appropriate measures to safeguard "all" data related to Bank or Program business—which necessarily includes Confidential Payment Card Data contained on Payment Cards issued by FIs. *See* Heartland Bank/HPS MPA at § 4.3.

Other Heartland Bank/HPS MPA provisions explicitly confer various rights on their "affiliates" (such as FIs). *See, e.g., id.* at § 1.2(e) (stating that HPS agrees to be responsible for certain losses to acquirer or its "affiliates"); § 1.5(f) (creating obligations from HPS to "affiliates" and others); § 4.3 (stating that Heartland Bank and HPS agree to safeguard data); and § 4.5(a) (stating that Heartland Bank and HPS agree to indemnify "affiliates" based on failure to comply with agreement, Visa or MasterCard operating regulations, and/or any breach of their representations or warranties in agreement). FIs, therefore, are intended third-party beneficiaries of the Heartland Bank/HPS MPA.

Heartland Bank nonetheless argues that since there is no explicit reference to the FIs within the "four corners" of the Heartland Bank/HPS MPA, it must follow that there was no intent to benefit FIs. Heartland Bank Memo. at 7–8. Heartland Bank's argument, however, fails to recognize that the parties' intent, which is rarely decided on a motion to dismiss where there is little or no extrinsic evidence, may be (and is) found outside of the "four corners" of an agreement.

Pursuant to Missouri law, a third-party beneficiary is one that is not a party to a contract, but is benefitted by it and may maintain a cause of action for its breach. *Stephens v. Great S. Sav. & Loan Ass'n*, 421 S.W.2d 332, 335 (Mo. Ct. App. 1967); RESTATEMENT (FIRST) OF CONTRACTS § 133 (1932).[9] Missouri law allows a claim where, as here, an object of the contact is to benefit the beneficiary. *Volume Servs., Inc. v. C.F. Murphy & Assocs., Inc.*, 656 S.W.2d 785, 794 (Mo. Ct. App. 1983). The beneficiary need not be named in the contract, but the terms of the agreement must clearly express intent to benefit such party or an identifiable person or class to which the party belongs. *Id.* The necessary intent to establish third-party beneficiary status is "not so much a desire to confer a benefit on the third person, or to advance the interest or promote the third person's welfare, but rather intent that the promissor assume a direct obligation." *Stephens*, 421 S.W.2d at 335.

Intent is to be gleaned from the contract itself, but if it is uncertain or ambiguous, then it should be determined from the circumstances surrounding its execution, including the apparent

[9] Missouri has adopted the RESTATEMENT (FIRST) OF CONTRACTS classification and definition of third-party beneficiaries. *Mertens v. MGR, Inc.*, 507 S.W.2d 433, 435–36 (Mo. Ct. App. 1974). Under § 133 of the RESTATEMENT, third-party beneficiaries are divided into three classes: donee, creditor and incidental beneficiaries. *Hardware Center, Inc. v. Parkedge Corp.*, 618 S.W.2d 689, 693 (Mo. App. 1981). The RESTATEMENT (SECOND) OF CONTRACTS § 302 dropped the terms "donee" and "creditor" as being obsolete, and replaced them with the single term "intended."

purpose the parties intended to accomplish. *J. Louis Crum Corp. v. Alfred Lindgren, Inc.*, 564 S.W.2d 544, 547 (Mo. Ct. App. 1978); *see also Volume Servs.*, 656 S.W.2d at 795; *U.S. v. Conservation Chem. Co.*, 653 F. Supp. 152, 208 (W.D. Mo. 1986) (denying motion for summary judgment on third-party beneficiary claim because of factual questions of parties' intent).

Notably, in *J. Louis Crum Corp.*, the court found that the plaintiff's third-party beneficiary status should be determined by the intent of the parties to the contract which, in turn, can be gleaned from the situation of the parties, the facts and circumstances surrounding the execution of the contract, and the purpose the parties intended to accomplish by the contract. *Id.*, 564 S.W.2d at 547. The defendant argued (as does Heartland Bank here) that the contract was clear and unambiguous such that an inquiry into intent was not required. The court, however, rejected defendant's argument, finding the position "much too narrow a view for the issues presented here. By the very nature of third party contracts, the situation of the parties is an essential factor in determining the rights and duties under the agreement." *Id.*

Here, while the Heartland Bank/HPS MPA does not specifically name FIs as third-party beneficiaries, as set forth above, the business relationships, including that of a joint venture, between FI, Heartland Bank, HPS and the other Visa/MasterCard Network members demonstrate an intent to confer a benefit upon FIs as an identifiable group. Indeed, a core purpose of the Heartland Bank/HPS MPA—establishing rules, procedures, and compliance requirements to ensure the security of Confidential Payment Card Data—clearly benefits FIs and the other members of the Visa/MasterCard Networks. Moreover, it is indisputable that the Heartland Bank/HPS MPA specifically does not preclude third-party beneficiary claims, nor can (or does)

Heartland Bank point to any express disclaimer language in the Heartland Bank/HPS MPA—because such language does not exist.[10]

In addition to being intended third-party beneficiaries of the KeyBank/HPS MPA under Ohio law, FIs are intended third-party beneficiaries of the Heartland Bank/HPS MPA under Missouri law. Heartland Bank's motion to dismiss FIs' breach of contract claim, therefore, should be denied.

III. FIs PROPERLY PLEAD BREACH OF FIDUCIARY DUTY

A. FIs' Complaint satisfies the *Twombly* and *Iqbal* standards

KeyBank argues that FIs' breach of fiduciary duty claim should be dismissed because FIs fail to state a claim upon which relief can be granted pursuant to the Supreme Court's holdings in *Iqbal* and *Twombly*. KeyBank Memo. at 10–11.

However, to survive a Rule 12(b)(6) motion to dismiss, a complaint "does not need detailed factual allegations," but its "allegations must be enough to raise a right to relief above the speculative level." *Bell Atl. Corp. v. Twombly*, 127 S. Ct. 1955, 1964–65 (2007). And, "[t]o survive a motion to dismiss, a complaint must contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (quoting *Twombly*, 127 S. Ct. at 1974). A claim "has facial plausibility when the plaintiff

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[10] Heartland Bank's half-hearted argument that FIs' breach of contract claim is barred by the "limitation of damages clauses" (Heartland Bank Memo. at 7) also does not hold water. Heartland Bank acknowledges that the Heartland Bank/HPS MPA allows for the recovery of "general money damages in an amount not to exceed the actual damages," and further permits the recovery of "special, incidental, consequential, or exemplary damages" in the event that there is a "willful breach" of the contract. *Id.* (citing § 4.7). In that regard, FIs allege that Heartland Bank and HPS "knowingly failed" to safeguard sensitive financial information, thereby breaching their contractual obligations. Compl. at at ¶¶ 9; 10; 13; 66; 67; 121. Furthermore, even assuming arguendo that FIs cannot demonstrate a "willful breach" of the Heartland Bank/HPS MPA, pursuant to the above provision, FIs nevertheless are entitled to recover "money damages" in an amount not to exceed their actual damages—which FIs specifically seek to recover. *Id.* at ¶¶ 11, 122. For this reason alone, Heartland Bank's motion to dismiss FIs' breach of contract claim should be denied.

pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.*; *see also Lehman Bros. Holding, Inc. v. Cornerstone Mortgage Co.*, No. H-09-0672, 2009 U.S. Dist. LEXIS 77523, at *13 (S.D. Tex. Aug. 31, 2009).

In *Lehman Bros.*, the defendant's counterclaim consisted of nothing more than the following language: "Defendant is entitled to its attorneys' fees and costs under Section 38.004 of the Texas Civil Practice and Remedy Code in that Plaintiff breached the contract by failing to properly service the loans and to give required notice." *Id.* at *16; (Doc. No. 17 at ¶ 64). Significantly, the defendant did not assert an independent counterclaim for breach of contract.[11] *Id.* at *7–8. This Court concluded that the defendant's counterclaim was deficient because it "simply alleged that a contract was breached by a failure to properly service the loans and to give notice," and dismissed it with leave to amend. *Id.* at *16–20. The ambiguous, "bare-bones," and "scant" allegations at issue in *Lehman Bros.* hardly provide Heartland with a basis to argue that FIs' Complaint is deficient under the *Twombly* and *Iqbal* standard.[12]

Distinct from *Lehman Bros.*, *Twombly*, and *Iqbal*, FIs' allegations consist of far more than mere "labels and conclusions, and a formulaic recitation of the elements of a cause of action." *See Lehman Bros*, 2009 U.S. Dist. LEXIS 77523, at *13–14 (internal citations omitted). KeyBank conveniently ignores the nearly forty-two pages of fact specific allegations intensively outlining the parties' business relationship underlying FIs' breach of fiduciary duty claim. This case is closely analogous to *Borneo Energy Send. Berhad v. Sustainable Power Corp.*, No. H-09-

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[11] As this Court observed, defendant's omission was fatal to its counterclaim for attorney's fees because the Texas fee-shifting statute "does not provide an independent cause of action for attorney's fees." *Lehman Bros.*, 2009 U.S. Dist. LEXIS 77523, at *6 (citations omitted).

[12] Indeed, this Court remarked that the allegations in the counterclaim were insufficient "under the standards that applied even before *Twombly* and *Iqbal*." *Lehman Bros.*, 2009 WL 2900740, at *5.

0612, 2009 WL 2498596 (S.D. Tex. Aug. 12, 2009) where this Court, applying the two-step analysis under *Twombly* and *Iqbal,* refused to dismiss a complaint alleging "facts that, if proven, would show these elements [of the cause of action]." *Id.* at *22. FIs meet this standard here.

As detailed in FIs' Complaint, Defendants are financial institutions that sought and gained membership in the Visa/MasterCard Networks. *See* Compl. at ¶ 1. Both Networks are structured as open business ventures whereby Defendants benefitted by serving as both Issuers and Acquirers through their membership. *Id.* HPS carried out certain duties and responsibilities as an agent for Defendants, who acted as both Issuers and Acquirers. *Id.* at ¶ 3. In so doing, Defendants were obligated, through contracts, applicable laws, and regulations, to employ the required knowledge, skills, and due care in performing those actions relevant to participation in the Networks. *Id.* at ¶ 7.

FIs allege that Defendants were obligated to monitor, audit, oversee and confirm that HPS' Payment Card transaction system safeguards were adequate, in place, monitored, managed, updated, maintained and fully operational. *See* Compl. at ¶¶ 7–9. To the detriment of many financial institutions, HPS failed to employ satisfactory safeguards. *Id.* at ¶ 9. Moreover, Defendants failed to monitor, audit, oversee, and confirm that HPS maintained such safeguards. *Id.* at ¶¶ 7–9. Beginning in or around December 2007, electronic hackers gained access to HPS' unprotected Payment Card transaction system and obtained Confidential Payment Card Data from approximately 130,000,000 Payment Cards. *Id.* at ¶ 8. All of these allegations are incorporated within FIs' breach of fiduciary duty claim. FIs' Complaint readily meets the *Iqbal* and *Twombly* pleading standard and is in no way "conclusory," Defendants' motion to dismiss FIs' breach of fiduciary duty claims should be denied.[13]

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[13] In the event the Court finds that FIs' allegations do not meet the *Iqbal* and *Twombly* standards, as well as other applicable law, FIs respectfully request an opportunity to conform their

B. FIs and Defendants are joint venturers

Defendants incorrectly argue that they and the FIs are not joint venturers within the context of the Visa/MasterCard Networks. *See* KeyBank Memo. at 13–15; Heartland Bank Memo. at 9–12. Defendants' arguments, however, conveniently ignore FIs' well pled allegations and supporting legal authority.

The Visa/MasterCard Networks are joint ventures or, as they refer to themselves, "membership associations," that are created, owned, governed and operated by their member banks. *In re Currency Conversion Fee Antitrust Litig.*, 263 F.R.D. 110, 114 (S.D.N.Y. 2009); *United States v. Visa U.S.A., Inc.*, 163 F. Supp.2d 322, 332 (S.D.N.Y. 2001) (stating that MasterCard and Visa are structured as open, joint venture associations with members (primarily banks) that issue payment cards, acquire merchants who accept payment cards, or both). The Visa/MasterCard Network members work together in and through the Networks to obtain financial benefits for themselves they could not secure independently, including globally recognized brands and sophisticated computer networks for processing transactions. *See Visa U.S.A.*, 163 F. Supp.2d at 332.

That said, FIs correctly allege that they and Defendants are members of the Networks and have a joint venture relationship with regard to, *inter alia*, processing Payment Card transactions through the Network interchange systems. Each Payment Card transaction—as well as the overall operation of the Networks—requires the parties' skill, knowledge and effort in a community of interest to achieve a common purpose, including the division of the agreed upon revenues and profits generated by such transactions. Compl. at ¶ 26.

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pleadings to the applicable standards. *See Lehman Bros.*, 2009 WL 2900740, at *5 (*citing Great Plains Trust Co. v. Morgan Stanley Dean Witter & Co.*, 313 F.3d 305, 329 (5th Cir. 2002)).

While FIs maintain that New Jersey law applies to their breach of fiduciary duty claims, even accepting Defendants' position that New York law applies to the transactions within the MasterCard Association, FIs properly allege the formation of a joint venture:

> A joint venture exists in New York when (1) two or more persons enter into an agreement for profit; (2) the parties intend to be associated as joint venturers; (3) each of the venturers contributes something of value to the venture, such as property, skill, knowledge or effort; (4) each co-venturer has some degree of control over the venture; and (5) the co-venturers agree to some division of profit and loss allocation.

Cosy Goose Hellas v. Cosy Goose USA, Ltd., 581 F. Supp.2d 606, 620 (S.D.N.Y. 2008) (citing *Dinaco Inc. v. Time Warner, Inc.*, 346 F.3d 64, 67–68 (2d Cir. 2003); *Itel Containers Int'l Corp. v. Atlanttrafik Express Serv. Ltd.*, 909 F.2d 698, 701 (2d Cir. 1989)).[14]

New Jersey law, which is less restrictive than New York law regarding formation of a joint venture,[15] applies to Visa Payment Card transactions. Since FIs meet the stricter requirements of proving the existence of a joint venture under New York law, as discussed *infra*, they clearly also have done so under New Jersey law. FIs and Defendants, therefore, are joint venturers for purposes of processing Payment Card transactions by and through their Visa/MasterCard Network memberships.

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[14] New Jersey law defines a joint venture to be "'[a] special combination of two or more persons where in some specific venture a profit is jointly sought without any actual partnership or corporate designation . . .'" *Nat'l State Bank of Newark v. Terminal Const. Corp.*, 217 F. Supp. 341, 351–52 (D.N.J. 1963) (quoting *Wittner v. Metzger*, 178 A.2d 671, 674–76 (N.J. Super. Ct. App. Div. 1962)).

[15] New Jersey law simply requires that the parties jointly seek a profit. *See Nat'l State Bank of Newark*, 217 F. Supp. at 341.

1. FIs and Defendants entered into agreements to make profits

By arguing that FIs fail "to allege that they and Heartland Bank have an agreement to share profits" (Heartland Bank Memo. at 10) and "do not and cannot allege any agreed sharing of profits" (KeyBank Memo. at 14), Defendants conveniently ignore FIs' allegations:

> In a Visa or MasterCard Payment Card purchase, the merchant actually receives approximately 98% of the price of the good or service sold. The remaining 2%, known as the "merchant discount," is the fee paid to the merchant's Acquirer bank for providing the Payment Card processing services. <u>The Acquirer, in turn, splits the fee with the Payment Card Issuer which receives approximately 1.4% of the purchase price</u>. The Issuer receives the majority of the fee because it owns the consumer's account and assumes the risk of non-payment. The 1.4% of the fee paid to the Issuer is called the "interchange fee."

Compl. at ¶ 34 (emphasis added).[16]

FIs, therefore, clearly allege the existence of an agreement between FIs and Defendants to share profits through processing Payment Cards transactions, as well as the actual percentage of the profit agreed to be shared by the joint venture members, *i.e.*, the Acquirers and Issuers. The agreement between FIs and Defendants satisfies the first prong of the joint venture test under the more restrictive New York law and, by definition, under the less restrictive New Jersey law.

2. FIs and Defendants intended to be joint venturers

The parties' actions also evidence their intent to form and operate a joint venture:

> MasterCard is open to any eligible financial institution. Similarly, any financial institution that is eligible for Federal Deposit Insurance Corporation deposit insurance can join Visa. Visa members have the right to issue Visa cards and to acquire Visa transactions from merchants that accept Visa cards. In exchange, they must follow Visa's by-laws and operating regulations. The same is true of MasterCard.

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[16] *See also Visa U.S.A.*, 163 F. Supp.2d at 332 (noting that issuer pays acquirer; acquirer in turn pays merchant, retaining small percentage of purchase price as fee for its services, which fee it then shares with issuer).

Visa U.S.A., 163 F. Supp.2d at 332.

FIs and Defendants, as members of the Visa/MasterCard Networks, necessarily rely on each other for the Networks to work. Each Payment Card transaction on the Networks requires the Acquirer and Issuer to work in lockstep with each other so that each may profit from every Payment Card transaction.[17] The Visa/MasterCard Network members agreed to this joint venture at the time they joined the Networks.[18] In short, the affirmative action of voluntarily joining the Networks, participating in and processing Payment Card transactions, and sharing transaction fees by and between themselves confirms the Parties' intent to be associated as joint venturers.[19]

3. FIs and Defendants contribute value to the ventures

FIs and Defendants, as members of the Visa/MasterCard Networks, clearly meet this prong of the joint venture standard. FIs expressly allege that the member financial institutions "combine their property, money, skills and knowledge in a community interest and with a common purpose." Compl. at ¶ 26. In other words, Visa/MasterCard Network members work together through the respective Networks to achieve financial benefits for themselves and each other they could not otherwise obtain independently. *Visa U.S.A.*, 163 F. Supp.2d at 332.

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[17] MasterCard Rules section 3.2, titled "Conduct of Activity," provides that "[e]ach member must conduct all Activity and otherwise operate in a manner that is financially sound and so as to avoid risk to the Corporation or other Members."

[18] Members of the Networks are financial institutions licensed or otherwise authorized by the Networks to issue the branded Payment Cards (Issuers), financial institutions that contract with merchants to accept Payment Cards (Acquirers), or both. Compl. at ¶ 39.

[19] The Associations (or Networks) "are legal 'associations' of members. By agreement and conduct each Association . . . constitutes an enterprise undertaken by their member financial institutions for the mutual benefit of all the members." Compl. at ¶ 26. Furthermore, "members (such as FIs and Defendants) . . . are contractually bound to each other." Compl. at ¶ 52.

4. FIs and Defendants each possess control over the ventures

Defendants argue that Issuers and Acquirers do not have control "over any other Issuer or Acquirer or over either card network as a whole" (KeyBank Memo. at p.14) and that "there is no plausible allegation of joint control" (Heartland Bank Memo. at p. 10). Defendants' atguments, however, are unavailing.

New York law, for example, requires that each co-venturer must have some degree of control over the venture in order for a joint venture to exist. *Cosy Goose Hellas*, 581 F. Supp.2d at 620. A close inspection of FIs' Complaint will confirm that the joint venture alleged by FIs herein lies within *the processing of Payment Card transactions using Payment Cards containing Confidential Payment Card Data through the Parties' membership in the Networks*, not control over the Networks as a whole. And, since FIs and Defendants each have a degree of control over their specific area of Payment Card transaction processing, they have the necessary control over the joint venture. As alleged by FIs the ability of the joint venture to succeed or fail is directly controlled by the Acquirer and Issuer. *See* Compl. at ¶¶ 30, 32–33, 36, 47–48.

Further supporting this position, the "MasterCard Rules" set forth the responsibilities of the Master Card Network members, including FIs and Defendants, in processing Payment Card transactions. Heartland Bank selectively argues that § 3.1 of the "MasterCard Rules" is evidence that MasterCard has sole control over the Network. However, § 3.1 does not use the word "control" and/or state the detailed responsibilities of MasterCard Network members. Instead, § 1.5.5 of the "MasterCard Rules," titled "Member Responsibilities," addresses member control, clearly requiring, *inter alia*, that each member "[a]t all times be entirely responsible for and Control all aspects of its Activities . . . ." Thus, the same "MasterCard Rules" Heartland advocates apply to FIs and Defendants also provide clear evidence that FIs and Defendants, as joint venturers, each possess some degree of control over the joint venture.

Similarly, Heartland Bank argues that § 1.7 of the Visa Regulations "vests sole control over the enforcement of Visa's operating regulations with Visa." *See* Heartland Memo. at 11. To reiterate, FIs allege that they and Defendants each *control the joint venture of processing Payment Card transactions using Payment Cards containing Confidential Payment Card Data through their membership in the Networks*; FIs do not allege that Defendants have control over Visa. Heartland Bank, however, incorrectly cherry picks an inapplicable section of the Visa regulations in a doomed effort to rebut FIs' allegations. On the other hand, the applicable section of the Visa regulations, titled "Additional Member Responsibilities," states that:

> 1.5.F.1.a A Member must:
>
> - Control approval and review of Merchants, approval of Cardholder applications and establishment of Merchant fees for Visa Transactions

Thus, both FIs and Defendants have sufficient control over the processing of Payment Card transactions by virtue of their membership in the Visa/MasterCard Networks, *i.e.,* the ventures, which establish the existence of a joint venture under New York law—and New Jersey law.

5. FIs and Defendants have an agreement to divide the profits

FIs and Defendants, as Visa/MasterCard Network members, clearly have agreed to divide the profits generated by processing Payment Cards transactions:

> In a typical payment card transaction, a merchant accepts a payment card from a customer for the provision of goods or services. The merchant then electronically presents the card transaction data to an 'acquirer,' . . . for Verification and processing. The acquirer presents the transaction data to the association (e.g. Visa or MasterCard) which in turn contacts the issuer . . . to check the cardholder's credit line. The issuer then indicates to the association that it authorizes or denies the transaction; the association relays the message to the merchant's acquirer, who then relays the message to the credit card terminal at the merchant's point of sale. If the transaction is authorized, the merchant will thereafter submit a request for payment to the acquirer, which relays the request, via the association, to the issuer.

> The issuer pays the acquirer; the acquirer in turn pays the merchant, retaining a small percentage of the purchase price as a fee for its services, which fee it then shares with the issuer.

Visa U.S.A., 163 F. Supp. 2d at 332 n.4 (emphasis added). *See also* Compl. at ¶ 32.

As explained, *supra*, FIs and Defendants have agreed to divide the 2% "merchant discount" on each Payment Card transaction—1.4% is paid to the Issuer (*i.e.*, the "interchange fee") and .6% is paid to the Acquirer. *See* Compl. at ¶ 34.[20]

KeyBank erroneously relies on *Visa U.S.A. Inc., v. First Data Corp.*, No. C 02-01786 JSW, 2006 WL 516662 (N.D. Cal. Mar. 2, 2006). In *First Data*, an antitrust case, the court rejected Visa's argument that Visa is a single entity. Here, FIs allege that they and Defendants are joint venturers in the processing of Payment Cards transactions by and through their Visa/MasterCard Network memberships, pursuant to which they divide the profits generated by the venture. Thus, the *First Data* holding that Visa is not a single entity supports FIs' argument that processing Payment Card transactions is evidence of the Parties' joint venture.

C. The Economic Loss Rule does not bar FIs' breach of fiduciary duty claim

KeyBank incorrectly argues that the economic loss rule, which typically applies to tort law claims brought by parties who are in contractual privity, bars FIs' breach of fiduciary duty claim. *See* KeyBank Memo. at 15–16. The only type of damages that typically arises from a breach of fiduciary duty claim is an economic loss. To bar recovery of economic losses arising out of a breach of fiduciary duty claim would leave no remedy for those harmed—especially in this case where the FIs' cost to re-issue compromised Payment Cards is an imminently foreseeable result of Defendants' wrongful action and/or inaction.

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[20] The MasterCard Rules include a "Loss Allocation Among Members" section, pursuant to which Members may be allocated any losses incurred by MasterCard due to the failure of a Member to perform any of its Membership obligations. *See id.* at § 2.17.

Both the Third and Tenth Circuits have addressed this issue and held that the economic loss rule *does not* bar claims for breach of fiduciary duty. *See Bohler-Uddeholm Am., Inc. v. Ellwood Group, Inc.*, 247 F.3d 79, 104 (3d Cir. 2001) (holding that application of economic loss doctrine "does not quite fit" a breach of fiduciary duty claim because "that doctrine developed in the context of courts' precluding products liability tort claims . . . ."); *United Int'l Holdings, Inc. v. Wharf (Holdings) Ltd.*, 210 F.3d 1207, 1226–27 (10th Cir. 2000) (holding that breach of fiduciary duty arising from parties' status as joint venturers is independent of contract that created joint venture, therefore economic loss doctrine does not bar claim); *Invo Fla., Inc. v. Somerset Venturer, Inc.*, 751 So. 2d 1263, 1266–67 (Fla. Dist. Ct. App. 2000) (finding that, in a case involving the "well-established" tort of breach of fiduciary duty against a director of a dissolved corporation, "the economic loss rule has not abolished the cause of action for breach of fiduciary duty, even if there is an underlying oral or written contract."). Similarly, FIs and Defendants are joint venturers and Defendants' breach of the fiduciary duties they owed to FIs occurred independently of the contract creating the joint venture.

KeyBank overreaches in citing *OC Prop. Mgmt., L.L.C. v. Gerner & Kearns Co., L.P.A.*, No. 90736, 2008 WL 4263563 (Ohio Ct. App. Sept. 18, 2008) as the only support for its position. In *OC Prop. Mgmt.*, the court dismissed a breach of fiduciary duty claim because the plaintiffs did not plead that a contract existed. Here, on the other hand, FIs plead the existence of a contract: the MPAs between Defendants and HPS. Compl. at ¶ 118. The economic loss rule does not bar FIs' breach of fiduciary duty claim.

IV. FIs PROPERLY PLEAD NEGLIGENCE

A. Federal courts routinely refuse to conduct a choice-of-law analysis when it requires consideration of materials beyond the pleadings

Defendants seek dismissal of FIs' negligence claim, asserting that the economic loss rule under Missouri, Ohio, and Texas law bars such a claim. In particular, Heartland Bank erroneously concludes that the Missouri choice-of-law provision in the Heartland Bank/HPS MPA requires the application of Missouri law to FIs' tort claims (Heartland Bank Memo. at 13), while KeyBank urges the application of Ohio or Texas law, citing Ohio as KeyBank's place of residence and Texas as the "forum with the greatest connection to the facts of the case . . . ." KeyBank Memo. at 9. Defendants' choice-of-law analysis pertaining to FIs' negligence claim, however, is premature and incomplete.

"A federal court is required to follow the choice of law rules of the state in which it sits." *Resolution Trust Corp. v. Northpark Joint Venture*, 958 F.2d 1313, 1318 (5th Cir. 1992). "When dealing with narrow choice of law provisions, Texas law requires an issue-by-issue choice of law analysis." *Benchmark Elecs., Inc. v. J.M. Huber Corp.*, 343 F.3d 719, 727 (5th Cir. 2003).

Courts do not entertain choice-of-law questions on a motion to dismiss when (as here) doing so would require the consideration of materials beyond the pleadings. *See, e.g.*, *Harper v. LG Elec. USA*, 595 F. Supp.2d 486, 490–91 (D.N.J. 2009) (observing that choice-of-law determinations require full factual record and refusing to rule on choice-of-law at 12(b)(6) stage); *Sioux Biochemical, Inc. v. Cargill, Inc.*, 410 F. Supp.2d 785, 800 (N.D. Iowa 2005) (refusing to conduct choice-of-law analysis in ruling on 12(b)(6) motion because most significant relationship test could not be conducted without reference to matters outside pleadings); *see also Mercedes-Benz USA, LLC v. ATX Group, Inc.*, No. 08-3529, 2009 WL 2255727, at *8 (D.N.J. Jul. 27, 2009) (refusing to conduct choice-of-law analysis when deciding 12(b)(6) motion "since the parties have yet to conduct any meaningful discovery"); *Floyd v. CIBC World Markets, Inc.*, No. H-08-3048, 2009 WL 2633791, at *11 (S.D. Tex. Aug. 25, 2009) ("The Court lacks evidence at this stage of the proceedings to properly analyze all the Restatement factors . . . . After appropriate time for discovery and presentation of evidence, the Court will apply these factors and make a choice of law determination."); *Jetpay Merchant Servs., LLC v. Miller*, No. 3:07-CV-0950-G ECF, 2007 WL 2701636, at *6 (N.D. Tex. Sept. 17, 2007) ("However, at this stage of the case, it is premature to determine whether or not the economic loss doctrine is applicable. As the plaintiff indicates, depending on which state's law governs, the economic loss doctrine may or may not be a valid defense, and until the choice of law issue is settled, the court will not speculate on how the doctrine may or may not apply.").

When information beyond the complaint is necessary to determine the law applicable to a plaintiff's claims, courts either: (i) refuse to entertain a motion to dismiss the applicable claims (*see, e.g., In re K-Dur Antitrust Litig.*, 338 F. Supp.2d 517, 541 (D.N.J. 2004) (finding it premature to determine, prior to class certification, which law to apply to various claims in an MDL proceeding)); or (ii) consider the motion to dismiss under the law that plaintiffs claim should apply (*see, e.g., Nakell v. Liner Yankelevitz Sunshine & Regenstreif, LLP*, 394 F. Supp.2d 762, 768 (M.D.N.C. 2005)). Either alternative precludes dismissal here.

B. A choice-of-law inquiry on FIs' negligence claim cannot be conducted on the pleadings alone; the Court should decide Defendants' dismissal motions under the applicable law alleged by FIs

The "most significant relationship test" governs the choice-of-law analysis in this case. *See DTEX, LLC v. BBVA Bancomer, S.A.*, 512 F. Supp.2d 1012, 1028 (S.D. Tex. 2007) (noting that Texas follows §§ 6 and 145 of the Second Restatement). Under this test, the Court is instructed to consider:

> (a) the place where the injury occurred, (b) the place where the conduct causing the injury occurred, (c) the domicile, residence, nationality, place of incorporation and place of business of the parties, and (d) the place where the relationship, if any, between the parties is centered.

RESTATEMENT (SECOND) CONFLICTS OF LAW § 145.

When weighing these four factors, it is not the number, but the qualitative nature of contacts that determines which state has the most significant relationship to the occurrence and the parties. *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 421 (Tex. 1984). Accordingly, the Court is directed to look to the principles of the RESTATEMENT (SECOND) CONFLICTS OF LAW § 6 to measure the significance of the contacts. *Torrington Co. v. Stutzman*, 46 S.W.3d 829, 848 (Tex. 2000). These factors include: (1) the needs of the interstate and international systems; (2) the relevant policies of the forum; (3) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue; (4) the protection of justified expectations; (5) the basic policies underlying the particular field of law; (6) the certainty, predictability and uniformity of result; and (7) the ease in the determination and application of the law to be applied. RESTATEMENT (SECOND) CONFLICTS OF LAW § 6.

Defendants strategically avoid this analysis in rushing to apply the law most favorable to them. Heartland Bank suggests that Missouri "necessarily" has the most significant relationship with this case because "the contract which purportedly gives rise to Plaintiffs' negligence claim stipulates that it is governed by Missouri law." Heartland Bank Memo. at 13. Even ignoring that the duty here arises from common law rather than the Heartland Bank/HPS MPA, Heartland Bank's *own cited authority* explicitly rejects the notion that a choice-of-law provision in a contract governs tort claims. *Red Roof Inns, Inc. v. Murat Holdings*, L.L.C. 223 S.W.3d 676, 684 (Tex. App.—Dallas 2007, no pet.) (stating that "[a] choice-of-law provision in a contract that applies only to the interpretation and enforcement of the contract and does not govern tort claims."); *see also Benchmark Elecs., Inc. v. J.M. Huber Corp.*, 343 F.3d 719, 727 (5th Cir. 2003) (holding that choice-of-law clause in contract did not govern tort claims); *Tex. Taco Cabana, L.P. v. Taco Cabana of N.M.*, 304 F. Supp.2d 903, 908 (W.D. Tex. 2003) (same).

Equally superficial is KeyBank's suggestion that Ohio or Texas law necessarily applies based on KeyBank's Ohio residence and the MDL Panel's decision to coordinate the HPS financial institution and consumer cases in this Court. KeyBank Memo. at 9 n.4. While KeyBank's residence is one of many factors to be considered under the Restatement test, it is hardly dispositive of the issue. Moreover, the MDL Panel—which based its decision on the applicable 28 U.S.C. § 1407 criteria—was concerned with the logistics of maintaining a coordinated proceeding, a consideration that has no bearing on the applicable test.[21] In other words, the MDL Panel clearly did not perform a choice of law analysis.

Contrary to Defendants' implied assumption, a choice-of-law analysis simply cannot be conducted on the pleadings alone in this matter. Defendants' headquarters in Missouri and Ohio do nothing to inform the Court about either the place of injury or the conduct causing the injury—two of the four elements provided within the Restatement. At this point, there is insufficient information concerning the location of substantive decisions regarding the oversight of HPS' Payment Card processing system security measures. Given that HPS is headquartered in New Jersey, it is entirely likely—indeed, even probable—that Defendants' relationships with HPS are centered in New Jersey and their wrongful conduct causing FIs' injuries occurred in New Jersey.

[21] And, while the MDL Panel coordinated the financial institution and consumer cases in this Court for pretrial proceedings, it subsequently declined to include the securities fraud cases against HPS in this MDL. Instead, it transferred the securities cases to the District of New Jersey, where HPS is headquartered.

The focus of FIs' Complaint is on Defendants' omissions, *i.e.*, Defendants' failure to properly oversee HPS. Because an omission is an act that does not happen, an omission does not "occur" in any location. Therefore, when analyzing an omission, the "location of conduct" is the place where the omitted act should have happened:

> Since an omission, by its very definition, is an act which failed to occur, an allegedly negligent omission cannot have actually "occurred" anywhere. Hence, Congress must have intended the applicable law under § 1346(b) in regard to a negligent omission to be that of the place where the act necessary to avoid negligence should have occurred . . . .
>
> Here, plaintiffs have alleged numerous wrongful or negligent omissions, including a failure to close down the facility and a failure to post signs. While these omissions may have stemmed in part from decisions made in San Francisco, California, the omissions could have been prevented only by the doing of such physical acts as the posting of signs, the erection of barbed wire, and the tearing up of boat slips and trailer spaces in Nevada. Contrary to plaintiffs' contention that California law applies to this case, the omissions "occurred" in Nevada, and Nevada whole law (including Nevada choice of law principles) governs the determination of liability of the United States.

Ducey v. United States, 713 F.2d 504, 508 n.2 (9th Cir. 1983).

In *Ducey*, the defendant made decisions at its headquarters in California. Plaintiff, however, complained about the defendant's failure to take necessary security acts in Nevada. As such, the court found that the omissions "occurred" in Nevada. Similarly, regardless of whether the Defendants made decisions at their headquarters in Missouri and Ohio, FIs complain of omitted acts that should have occurred in New Jersey. Accordingly, when applying the second factor of the most significant relationship test, New Jersey is the place where the conduct causing FIs' injuries occurred.

Additionally, given that HPS is a New Jersey corporation, New Jersey has a strong interest in ensuring Defendants' proper oversight of HPS. Since HPS maintains its principal place of business in New Jersey, New Jersey has an interest in ensuring that entities doing business with HPS behave in accordance with their duty to exercise proper oversight over HPS.

This is especially true here given that some of the putative Class members are New Jersey financial institutions. Accordingly, New Jersey law applies to FIs' negligence claim and, pursuant to the above analysis, such claims are properly pled and should survive Defendants' motions to dismiss. *See Nakell*, 394 F. Supp. 2d at 768 (analyzing motion to dismiss under law plaintiff claimed should apply).

C. The Economic Loss Rule does not bar FIs' negligence claim under New Jersey law

Under New Jersey law, the test for recovery of economic losses in tort is both straightforward and well-settled: a plaintiff may recover purely economic losses if they are members of an identifiable class that the defendant should have reasonably foreseen was likely to be injured by its conduct. *Carter Lincoln-Mercury, Inc. v. EMAR Group, Inc.*, 638 A.2d 1288, 1294 (N.J. 1994) (citing *People Express Airlines, Inc. v. Consol. Rail Corp.*, 495 A.2d 107, 116 (N.J. 1985)).

In *People Express Airlines* the New Jersey Supreme Court explained that under New Jersey law, "a defendant owes a duty of care to take reasonable measures to avoid the risk of causing economic damages, aside from physical injury, to particular plaintiffs or plaintiffs comprising an identifiable class with respect to whom defendant knows or has reason to know are likely to suffer such damages from its conduct." *Id.*, 495 A.2d at 116. "A defendant failing to adhere to this duty of care may be found liable for such economic damages proximately caused by its breach of duty." *Id.*

The court *in People Express Airlines* discussed the types of plaintiffs who do *not* meet this test, including "members of the general public, or invitees such as sales and service persons at a particular plaintiff's business premises, or persons travelling on a highway near the scene of a negligently-caused accident, such as the one at bar, who are delayed in the conduct of their affairs and suffer varied economic losses . . . ." *Id.* The court found that such plaintiffs would be present in the area of the accident fortuitously and "the particular type of economic injury that could be suffered by such persons would be hopelessly unpredictable and not realistically foreseeable." *Id.* Here, on the other hand, FIs are not random members of the general public or salesmen who fortuitously happened to be in the area where an accident occurred. Rather, FIs' memberships and roles in the Visa/MasterCard Networks, as well as their entrustment of Confidential Payment Card Data to Defendants and their agent, HPS, are central to Payment Card transaction processing. *See* Compl. at ¶¶ 55–63.

According to *People Express Airlines*, "[a]n identifiable class of plaintiffs must be particularly foreseeable in terms of the type of persons or entities comprising the class, the certainty or predictability of their presence, the approximate numbers of those in the class, as well as the type of economic expectations disrupted." *Id.*, 495 A.2d at 116. Here, the FI Issuers and their involvement in the Payment Cards transaction processing process were (and continue to be) absolutely certain and predictable and never could be portrayed as "hopelessly unpredictable." *See* Compl. at ¶¶ 39–47, 52–54.

FI Issuers constitute one of the four key participants (along with the customer, the merchant, and the Acquirers) in the Payment Cards transaction processing process. *Id.* at ¶¶ 39–47. To consider them to be incidental, unpredictable and/or fortuitous victims of the Data Breach defies logic and the indisputable facts of this case. *See id.*

The approximate number of injured FIs also is certain and predictable as Defendants know the precise identities of the FI Issuers injured by the Data Breach and Defendants' wrongful actions and/or inaction—if for no other reason that such knowledge is required to process the Payment Card transactions.

Finally, the type of economic expectations disrupted are certain and predictable because Defendants are well aware that FI Issuers have policies in place requiring them to reimburse their customers for certain fraudulent transactions and/or re-issue compromised Payment Cards in the event of security breaches like the Data Breach here. *See id.* at ¶ 40. After considering all of the factors applied under New Jersey law, it is clear that the economic loss rule does not prohibit FIs from recovering their economic damages caused by Defendants' negligence.

Attempting to persuade the Court otherwise, Defendants provide a number of authorities standing for the proposition that the economic loss rule bars negligence claims in data security breach cases. Heartland Bank Memo. at 13; KeyBank Memo. at 16. Defendants' authorities, however, are cherry picked from jurisdictions that, *unlike New Jersey*, actually prohibit the recovery of economic losses in tort. *See TJX Cos., Inc. Retail Sec. Breach Litig.*, 564 F.3d 489, 498–99 (1st Cir. 2009) (applying Massachusetts law); *Sovereign Bank v. BJ's Wholesale Club, Inc.*, 533 F.3d 162, 179–80 (3d Cir. 2008) (applying Pennsylvania law); *Pa. State Employees Credit Union v. Fifth Third Bank*, 398 F. Supp. 2d 317, 326 (M.D. Pa. 2005) (applying Pennsylvania law); *CUMIS Ins. Soc., Inc. v. BJ's Wholesale Club, Inc.*, No. 051158, 2005 WL 6075375, at *4 n.4 (Mass. Super. Ct. 2005) (applying Massachusetts law). None of these authorities is persuasive, much less dispositive, of FIs' negligence claim under New Jersey law.

D. Defendants owe FIs a legal duty

KeyBank incorrectly suggests that it owes no duty to FIs because "card issuers already protect themselves against the risk of credit card data being stolen and misused through the Visa and MasterCard regulations."[22] KeyBank Memo at 17.

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[22] Even if this argument had merit—which it does not—it goes to the issue of whether the damages for which Defendants are liable could potentially be offset by any possible contributory negligence on the part of the FIs. This argument is not relevant to whether Defendants owed FIs a legal duty in the first place.

Under New Jersey law, the question of whether a duty exists is one of fairness and policy that implicates many factors—with the foreseeability of harm being a significant consideration. *Carvalho v. Toll Bros. & Developers*, 675 A.2d 209, 212 (N.J. 1996). While foreseeability alone does not establish a duty, it is "a crucial element" in determining whether a duty should be imposed. *Id.* Once foreseeability is established, fairness and policy considerations govern whether the imposition of a duty is warranted. *Id.* This "involves identifying, weighing and balancing several factors—the relationship of the parties, the nature of the attendant risk, the opportunity and ability to exercise care, and the public interest in the proposed solution." *Id.*

The New Jersey Supreme Court recently explained that the determination of whether a duty exists is "very fact-specific and principled" because it "must lead to solutions that properly and fairly resolve the specific case and generate intelligible and sensible rules to govern future conduct." *Brunson v. Affinity Fed. Credit Union*, 972 A.2d 1112, 1124–25 (N.J. 2009) (citing *Fox & Lazo Realtors*, 625 A.2d 1110 (N.J. 1993)). As an initial matter, therefore, the fact-intensive nature of the duty inquiry renders KeyBank's motion on this issue entirely premature. *See Wang v. Allstate Ins. Co.*, 592 A.2d 527, 534 (N.J. 1991) ("Of course, the legal determination of the existence of a duty may differ, depending on the facts of the case."); *J.S. v. R.T.H.*, 693 A.2d 1191, 1193 (N.J. Super. Ct. 1997) ("The facts of a case inform the court in determining whether a duty exists."). As with the choice-of-law determination, therefore, the decision of whether a legal duty exists should wait for a fully developed factual record.

Even if the Court were to consider the existence and scope of Defendants' duty on the pleadings alone, it is easily demonstrated here. For example, in *Carvalho*, the New Jersey Supreme Court found that a project engineer owed a legal duty to protect workers despite the absence of any contractual responsibility for the engineer to provide site safety. 675 A.2d at 214-15. In *Carvalho*, a workman was killed when unstable trench walls collapsed upon him.

Carvalho, 675 A.2d at 210–11. The defendant was required to have an inspector at the site to monitor the work's progress, but not the work's safety. *Id.* at 211. In determining whether the defendant nonetheless owed a duty to the workman, the *Carvalho* court found the risk of worker injury was easily foreseeable under the circumstances—*i.e.*, the risk that deep trench walls could collapse and seriously injure workers. *Id.* For that reason, the defendant's contract provided for the specific possibility of unstable trench conditions and prescribed contractual duties addressing those concerns. *Id.* at 213–14. Trenches in other areas of the site also had collapsed several times during the construction. *Id.* at 214.

Just as a trench collapse injuring workers is foreseeable in the realm of trench digging, the Data Breach requiring FIs to re-issue compromised Payment Cards and absorb fraudulent charges is foreseeable in the realm of Payment Card transaction processing. *See id.* at 213; *see also Olivo v. Owens-Illinois, Inc.*, 895 A.2d 1143, 1149 (N.J. 2006) (finding Exxon owed duty not just to workers on Exxon's premises who were exposed to asbestos, but also to their spouses who foreseeably were exposed to their spouses' asbestos-containing clothing); *Bahrle v. Exxon Corp.*, 652 A.2d 178, 194 (N.J. Super. Ct. App. Div. 1995) (concluding that area residents comprised foreseeable class potentially harmed by negligent discharge from gas station).

Defendants cannot credibly argue otherwise, as a host of federal and industry regulations—including detailed FDIC rules—discuss proper Payment Card transaction processing and the provision of adequate security controls for Confidential Payment Card Data. Compl. at ¶¶ 18–51. Were that not enough, the widely-publicized theft of customer confidential information from Hannaford Brothers and TJX Companies should have prompted Defendants to ensure that the deficiencies in the Hannaford Brothers and TJX computer systems did not exist at HPS. Compl. at ¶ 67.

Once foreseeability is established, the analysis turns to fairness and policy considerations, including the (i) parties' relationship, (ii) nature of the attendant risk, (iii) opportunity and ability to exercise care, and (iv) public interest in the proposed solution. *Carvalho*, 675 A.2d at 212. Regarding the Parties' relationship, New Jersey law plainly allows a legal duty to be imposed despite the absence of any direct relationship, contractual or otherwise. *See Carter Lincoln-Mercury, Inc. v. EMAR Group, Inc.*, 638 A.2d 1288, 1294–95 (N.J. 1994) (stating that "[a] number of our [New Jersey] cases have recognized that lack of privity between the plaintiff and the alleged tortfeasor is no bar to recovery based on negligence"); *Barner v. Sheldon*, 678 A.2d 767, 768 (N.J. Super. Ct. Law Div. 1995) (stating that duty does not require direct relationship); *Aronsohn v. Mandara*, 484 A.2d 675, 682–83 (N.J. 1984) (holding that lack of privity of contract between building contractor and third persons does not bar recovery for those injured by defendant's negligence).

As such, an injured party may recover for an economic loss resulting from a negligently performed service if the injured party was a known beneficiary of the defendant's undertaking. *H. Rosenblum, Inc. v. Adler*, 461 A.2d 138, 143 (N.J. 1983). Without question, FI Issuers are direct, known beneficiaries of Payment Card transaction processing. Compl. at ¶¶ 24–38. Defendants, therefore, had (and continue to have) a duty to FIs to make sure that the Payment Card transaction processing system utilized by its agent, HPS, properly safeguards the Confidential Payment Card Data entrusted to them.

Defendants' responsibility for conditions creating the risk of harm—*i.e.*, the Data Breach—further underscore Defendants' duty to FIs. In *Carvahlo*, the court found that even though safety matters only bore "indirectly" on the contractual responsibility for work supervision, the "circumstances demonstrate the interrelationship between safety and progress." 675 A.2d at 213–14.

As Acquirers, Defendants assumed the risks associated with Payment Card transactions, including processing the transactions properly and safeguarding the Confidential Payment Card Data. Compl. at ¶ 48. Accordingly, Defendants were directly responsible for the conditions creating the risk and ultimately, the Data Breach itself. Defendants also had the opportunity and ability to exercise care over their agent, HPS. Compl. at ¶ 24. There can be no dispute that Defendants owed FIs a legal duty here—which, incredibly, Defendants now seek to avoid.

V. FIs PROPERLY PLEAD VICARIOUS LIABILITY

A. Similar to FIs' negligence claim, a choice-of-law analysis with respect to FIs' vicarious liability claim is premature

In *Cates v. Creamer*, the Fifth Circuit decided a choice-of-law dispute involving a vicarious liability claim where the defendant, Creamer, rented a car in Florida from Hertz. *See* 431 F.3d 456, 463–66 (5th Cir. 2005). Creamer then drove the car to Texas where he crashed into a car containing the plaintiff, Cates. *Id.* Cates sued Creamer and Hertz in Texas to collect damages for her resulting injuries. *Id.* The Fifth Circuit agreed with Cates' argument that under Texas's choice-of-law rules, the court must apply Florida law to her vicarious liability claim against Hertz *Id.* at 458–59, 466.

In conducting its choice-of-law analysis, the court first analyzed the factors in RESTATEMENT (SECOND) CONFLICT OF LAWS § 145. *Id.* at 464. The court reasoned that although the injury and the conduct causing the injury occurred in Texas, the factors are meant to be "evaluated according to their relative importance with respect to the particular issue." *Id.* at 464 (quoting RESTATEMENT (SECOND) CONFLICT OF LAWS § 145). With respect to the vicarious liability claim, the most important factor was "where the relationship . . . between the parties was centered." *Cates*, 431 F.3d at 465. The court explained that:

> [T]he most relevant relationship is that which arises from the lease of the automobile. . . . Texas has no relationship with the lease, and Hertz has no

> relationship with Texas concerning this lease. . . . Creamer, however, is a Florida resident and is a party to the lease. Hertz is the other party to the lease and does its relevant business in Florida. Florida is the situs where the lease was executed. In short, Florida, not Texas, has the most significant relationship to the issue of Hertz's vicarious liability.

Id.

Next, the court evaluated the factors from RESTATEMENT (SECOND) CONFLICT OF LAWS § 6. *Id.* The court concluded that neither Texas nor Florida had a particularly strong interest in having its vicarious liability law applied to Cates' claim against Hertz. *Id.*

Texas had an interest in compensating Cates for her injuries, but Florida law offered greater protection of that interest. *Id.* Florida's interest in having its law applied was also minimal because although Florida's dangerous instrumentality doctrine protected plaintiffs from dangerous drivers by imposing liability on the owners of the vehicles, Cates was not a Florida resident. *Id.* Thus, because the interests of neither state clearly predominated, the court held that Florida had the most significant relationship to the facts and circumstances as they related to the vicarious liability issue since the relationship between Hertz and Creamer was centered in Florida. *Id.* at 465–66; *see also Dunn v. Madera*, No. 7:05-CV-041-R, 2006 WL 3734210, at *5–6 (N.D. Tex. Dec. 18, 2006) (holding that under Texas choice-of-law doctrine, Colorado law applied to plaintiff's vicarious liability claim because even though accident occurred in Texas, defendant rented car in Colorado).

Applying this choice-of-law analysis to the vicarious liability claim here, it quickly becomes apparent that, as with FIs' negligence claim, the Court cannot make an informed choice-of-law determination on FIs' vicarious liability claim before the factual record is adequately developed. Regardless of where FIs' injuries occurred, the most important factor in the choice-of-law analysis regarding FI' vicarious liability claims is where the business relationships between HPS and Defendants are centered. *See Cates*, 431 F.3d at 465. At this early stage in the litigation, the facts—such as where HPS and Defendants negotiated, drafted and executed the MPAs and/or where performance of the MPAs occurred (or should have occurred)—are not developed enough to make this determination. *See Cates*, 431 F.3d at 465. Unlike the lessor/lessee relationship underlying the court's choice-of-law decision in *Cates*, the business relationships between HPS and Defendants are not so clearly confined to one state.

B. FIs properly plead a vicarious liability claim under New Jersey Law[23]

Defendants contend that because their MPAs with HPS expressly state that HPS is an independent contractor and not an agent, FIs' claims for vicarious liability must fail as a matter of law. Heartland Bank Memo. at 14; KeyBank Memo. at 19. Defendants' contentions are incorrect because an agency relationship is not established by words or intent, but by actual conduct. In that regard, FIs allege that Defendants are vicariously liable for HPS' negligence because (i) Defendants' conduct created an agency relationship with HPS; (ii) HPS was at all times acting within the scope of its authority as Defendants' agent; and (iii) HPS' negligence in performing its duties as Defendants' agent proximately caused FIs' injuries—all of which constitute actual conduct of Defendants and HPS. *See* Compl. at ¶¶ 54–58, 135–52.

Under the doctrine of vicarious liability, a principal is liable for the tortious acts of an agent acting within the scope of its authority. *Baldasarre v. Butler*, 625 A.2d 458, 463 (N.J. 1993); *see also Jarrah v. Trump Hotels & Casino Resorts, Inc.*, 487 F. Supp. 2d 522, 529 (D.N.J. 2007). An agency relationship is created when one party consents to have another act on its behalf, with the principal controlling and directing the acts of the agent. *Sears Mortgage Corp. v. Rose*, 634 A.2d 74, 79 (N.J. 1993); RESTATEMENT (SECOND) OF AGENCY § 1 (1958).

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[23] As with their negligence claim, FIs assert that their vicarious liability claim is governed by New Jersey law. *See Nakell*, 394 F. Supp.2d at 768 (analyzing motion to dismiss under law plaintiff alleged should apply).

New Jersey law provides that an express agreement is not necessary to create an agency relationship between two persons or entities; rather, "the law will look at their conduct and not to their intent or their words as between themselves but to their factual relation." *Henningsen v. Bloomfield Motors*, 161 A.2d 69, 78 (N.J. 1960); *see also Salamon v. Teleplus Enters.*, Inc., 2008 WL 2277094, at *13 (D.N.J. June 2, 2008); *Sears Mortgage Corp.*, 634 A.2d at 79. "[D]irect control of principal over agent is not absolutely necessary; a court must examine the totality of the circumstances to determine whether an agency relationship existed even though the principal did not have direct control over the agent." *Sears Mortgage Corp.*, 634 A.2d at 80.

In *Henningsen v. Bloomfield Motors*, the New Jersey Supreme Court used these general principles to determine whether an agency relationship existed between an automobile manufacturer and its dealership. 161 A.2d at 73. In *Henningsen*, the plaintiff sued the dealership (Bloomfield) and the manufacturer (Chrysler) for breach of the implied warranty of merchantability after his wife was injured in an accident caused by a defective vehicle. *Id.* The court found that "[a]lthough the franchise agreement between the defendants recites that the relationship of principal and agent is not created, in particular transactions involving third persons the law will look at their conduct and not to their intent or their words as between themselves but to their factual relation." *Id.* at 78.

The court ultimately held that Bloomfield was acting as Chrysler's agent, stating that "[t]he evidence is overwhelming that the dealer acted for Chrysler in including the warranty in the purchase contract." *Id.*; *see also Mann v. Interstate Fire & Cas. Co.*, 705 A.2d 360, 365–66 (N.J. Super. Ct. App. Div. 1998) (holding that trial court erred in granting summary judgment because genuine issues of material fact existed with respect to agency despite fact that defendants' agreement expressly stated that it did not create agency relationship).

Similarly, and despite the fact that Defendants' MPAs with HPS state that HPS is acting as an independent contractor in performing its services under the agreements, FIs properly plead that HPS was actually acting as an agent under the direct authority and control of Defendants, its principals and sponsors into the Visa/MasterCard Networks. Compl. at ¶¶ 54–58, 135–52. Specifically, FIs allege that the MPAs allowed HPS to utilize Defendants' Bank Identification Numbers ("BINs").[24] *Id.* at ¶¶ 54 and 136. Utilizations of Defendants' BINs allowed HPS to route Visa and MasterCard transactions under Defendants' control to process Payment Card transactions. *Id.*

The MPAs also imposed upon Defendants the right and the obligation to (i) compel HPS to provide them with information pertaining to HPS' compliance with the Visa and MasterCard rules and regulations, (ii) inspect, monitor, test, examine, audit, oversee and confirm that HPS' Payment Card processing system safeguards were adequate and complied with all applicable laws and guidance, were in place, were being properly monitored, managed, updated, maintained, and were fully operational, and (ii) control HPS' Payment Card processing system security protocols and programs. *Id.* at ¶¶ 54–55, 137–38. The MPAs also permitted HPS to acquire merchants on behalf of Defendants. *Id.* at ¶¶ 55, 139.

At all relevant times, HPS acted in the course and scope of its duties as Defendants' agent. Compl. at ¶¶ 55–57, 141–49. Nothing HPS did was contrary to the authority given to it by Defendants. *Id.* at ¶¶ 56, 145–48. Defendants gave HPS the authority to act on their behalf and retained the right to control and direct the manner and/or means by which HPS should have secured the Confidential Payment Card Data as it was being routed through the Visa/MasterCard Networks. *Id.* at ¶¶ 56 & 143. None of HPS' actions involving the "routing" of Confidential

[24] BINs are the first four to six digits listed on a Payment Card. The BINs identify the institution issuing the card and allow for correct matching of transactions to the Payment Card Issuers.

Payment Card Data through the Networks was for the sole benefit of HPS. *Id.* at ¶¶ 56, 148. Rather, HPS' "routing" of Confidential Payment Card Data through the Networks provided substantial revenue and profits to Defendants. *Id.* Moreover, Defendants ratified and approved HPS' actions surrounding the security of its Payment Card processing system and the Data Breach itself. *Id.* at ¶¶ 57 & 149. HPS' failure to ensure the security of Confidential Payment Card Data as it was being routed through the Networks directly and/or proximately caused FIs' damages in the form of unauthorized charges and the costs to re-issue compromised Payment Cards. *Id.* at ¶¶ 29, 57–58, 76, 152.

FIs properly that Defendants created an agency relationship with HPS by allowing HPS to act on their behalf through the MPAs while simultaneously maintaining control over HPS' acts and directing HPS' acts as their agent. *See Sears Mortgage Corp.*, 634 A.2d at 79; *Henningsen*, 161 A.2d at 78; RESTATEMENT (SECOND) OF AGENCY § 1 (1958). HPS was at all relevant times acting within the scope of the authority given to it by Defendants, and HPS's negligence proximately caused injuries to FI Plaintiffs. Defendants' motions to dismiss FIs' vicarious liability claim, therefore, should be dismissed.

VI. SUBROGEE CLAIMS

FIs hereby withdraw all claims asserted on behalf of the alleged Subrogee Class. Because the subrogees of FIs are suing directly in the name of FIs, a separate Subrogee Class is not necessary.

VII. CONCLUSION

FIs, therefore, respectfully request that the Court deny Defendants' motions to dismiss in their entirety and grant FIs such other and further relief to which FIs are justly entitled.[25]

Respectfully submitted,

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[25] In the event the Court grants either or both of Defendants' motions to dismiss, it should be without prejudice. *See, e.g.*, *Borneo*, 2009 WL 2498596, at *5 ("When a plaintiff's complaint fails to state a claim, the court should generally give the plaintiff at least one chance to amend the complaint under Rule 15(a) before dismissing the action with prejudice.").

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was filed via the Court's ECF system on May 21, 2010, and thereby served on all counsel of record.

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