

The complaint

A company I'll call C complains that PayPal (Europe) Sarl et Cie SCA (PayPal) blocked its account and applied a reserve of £565,000, meaning PayPal would deduct 50% of all payments received until C's account balance hit the reserve amount.

C is represented by one of its directors, Mr M.

What happened

In August 2022, PayPal blocked C's account while it carried out a review. It asked various questions about C's business before releasing the block. However, it then decided a further review was necessary, so it applied a second block and raised further questions. When it completed its review, it decided C's business model was high risk, so it applied a reserve to C's account of £565,000.

Mr M complained, but PayPal didn't change its position. It issued a final response letter on 15 September 2022. It said the reserve was to protect PayPal from financial risks such as chargebacks and claims, and that its review had determined there may be a high level of risk associated with C's account.

It told C it had allocated £69,600 of its account balance to the reserve and that it would divert 50% of all future payments PayPal received through C's account to the reserve, until the £565,000 limit had been reached. It said C could move its business away from PayPal if it preferred, at which point it would release C's account balance once C had fulfilled any unfulfilled orders.

Mr M remained unhappy, so he brought his complaint to our service. Our Investigator raised a number of enquiries of PayPal to assess whether it had acted fairly and reasonably in applying the reserve. PayPal didn't respond to most of our Investigator's questions, so she issued her findings based on the information available to her.

She was satisfied that PayPal was entitled to block C's account while it carried out a review, and that the account terms and conditions entitled PayPal to introduce a reserve to a customer's account. However, she said she explained to PayPal what evidence it would need to provide in order to demonstrate it had acted reasonably in applying the reserve on this occasion, but that PayPal had failed to submit such evidence. So, she couldn't be satisfied PayPal had acted reasonably in applying the reserve.

She said PayPal should pay simple interest on the balance of £75,630.59 at the rate of 8% for the period the funds were withheld (2 September 2022 until 12 May 2023), as well as £200 in recognition of the inconvenience C had experienced as a result of PayPal's actions.

Mr M accepted our Investigator's findings, but PayPal didn't so it asked for an Ombudsman to review the matter afresh. PayPal didn't submit any further information or evidence to counter our Investigator's findings, so I wrote to it indicating that our Investigator's outcome seemed reasonable in the particular circumstances of this case, and explaining that it would need to justify its position with evidence if it wanted me to reach a different conclusion.

PayPal replied with a copy of its review notes taken at the time it decided to implement the reserve. It said those notes demonstrated the risk it faced, but invited me to confirm if I needed further information. I replied setting out a list of questions our service would need answering and encouraged PayPal to provide evidence in support of its answers where possible and express its answers to my questions as clearly as possible.

PayPal replied, repeating the contents of its review notes, but it didn't directly answer my questions or submit any further evidence in support of its position.

What I've decided – and why

I've considered all the available evidence and arguments to decide what's fair and reasonable in the circumstances of this complaint.

I accept PayPal's terms of business entitle it to apply a reserve to a customer's account in certain circumstances. But our service would expect to see justification for a reserve, particularly such a high value reserve as in this case, to ensure PayPal has treated its customer fairly and reasonably, so PayPal's discretion in this regard is not unfettered.

With that in mind, I've looked at the evidence PayPal sent our service, to understand why it applied the reserve, why it chose a value of £565,000, and whether or not it treated C fairly in doing so. And having done so, I'm not persuaded it treated C fairly and reasonably when it applied the reserve. I'll explain why.

PayPal's primary concern with C was that it had a high volume of pre-sales, which it estimated at 30% of C's sales. PayPal estimated C's business model gave rise to a "non-delivery exposure" of 147 days. I accept that those circumstances give rise to a theoretical risk to PayPal, as it could have to refund transactions that C didn't fulfil. And I think it's axiomatic that, all other things being equal, long periods between payment for goods and delivery of those goods carries a greater risk of claims than goods delivered immediately upon payment.

However, the point of the questions I asked PayPal was to get it to demonstrate why the theoretical risk justified withholding over half a million pounds of C's money. Mr M explained to our service that 50% of his income wouldn't even cover his costs of purchasing stock, so PayPal's reserve would strangle C's business. If I felt PayPal's reserve was fair and reasonable, that would either be a cost of business C would have to live with, or C was free to use a different service provider.

But PayPal hasn't, in my determination, done enough to justify its actions. I asked it to provide call notes or call recordings with Mr M to demonstrate the information PayPal had used in assessing C's business as high risk, but it didn't provide either: only notes of its review. PayPal had told our service that there were 160 claims on C's account "from January 2020", but it didn't confirm the end date of that period when asked. And it only submitted evidence of 75 claims, the vast majority of which were for less than £100.

I asked PayPal to confirm how many transactions had proceeded without claims, but it didn't give a clear answer. On that point, its review notes said "*...well established activity with excellent performance.*" and provided a "lifetime revenue" figure of \$154,400.61. But PayPal gave no context to clearly explain what it meant.

The review notes stated PayPal's exposure was £676,000 and recommended a minimum reserve of £210,000. But again, PayPal provided nothing to demonstrate how it had reached those values, and it didn't explain, when asked, why it imposed a reserve of £565,000 when

the recommendation was for “at least £210,000”. And I would expect PayPal to be able to provide some explanation or justification as to how it reached such a high figure and why it didn’t simply apply the minimum recommendation.

Further, if lifetime revenue meant money C received to its PayPal account between January 2020 (being the date PayPal gave for the start of its claims received data) and August 2022 (being the date of its review), it’s hard to see how a reserve of £565,000 is justified. By that metric, the reserve would cover approximately 9 years of revenue from C, which is clearly completely disproportionate to the risk PayPal says it was concerned about.

But ultimately, the issue I have with PayPal’s explanation is that it hasn’t been sufficiently clear on its position, despite being asked to provide such clarity (and evidence) on several occasions. So, the lifetime revenue figure could very easily have a completely different meaning and without further explanation, doesn’t assist PayPal’s position.

PayPal has said that the reserve wasn’t based on claims, it was based on risk. And that it was seeking to protect itself from that risk. But I’m not satisfied PayPal has properly demonstrated that risk to our service, such that it can justify a reserve of £565,000. Or that the reserve was reasonable in order to protect PayPal from its perceived risk. And I’m not persuaded that the surrounding circumstances support its decision.

To be clear, I’m not saying PayPal isn’t entitled to place a reserve on a customer’s account if it is concerned that not doing so will expose it to an unacceptable risk. And in other circumstances, I might reach a different outcome, particularly if PayPal provides more substantial evidence in support of its actions and/or answers the questions our service asks it. But quite simply, for the reasons I’ve set out above, I’m not satisfied PayPal has justified its position to our service. And so, I can’t say that PayPal’s actions were fair and reasonable in all of the circumstances of this particular case.

Because I’m not satisfied the reserve was fair and reasonable, I’ve looked to see what compensation, if any, would be appropriate. When a complainant hasn’t had use of their funds they should have, our service would generally award 8% simple interest per annum on the value of the funds. It’s not possible for us to reconstruct every financial decision C made during the period in question, to calculate the true impact. So, the awarding of 8% interest is to reflect the overall loss of use of these funds for that period. In this case, I’m satisfied that it’s appropriate for PayPal to pay C this interest for this period.

C’s account balance while the reserve was in place was £75,630.59, and those funds were retained from 2 September 2022 until 12 May 2023, so that is the period in respect of which interest must be paid.

PayPal must also pay C £200 in respect of the inconvenience these problems caused C, i.e. in recognition of the time C’s director’s attention was diverted away from C’s business to deal with this issue.

My final decision

My final decision is that I uphold this complaint. To put things right, PayPal (Europe) Sarl et Cie SCA must pay C:

1. Simple interest at the rate of 8% on C’s account balance of £75,630.59 from 2 September 2022 to 12 May 2023; and
2. £200 in recognition of the inconvenience it caused C.

Under the rules of the Financial Ombudsman Service, I'm required to ask C to accept or reject my decision before 10 May 2024.

Alex Brooke-Smith
Ombudsman