UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

NACS; NATIONAL RETAIL FEDERATION; FOOD MARKETING INSTITUTE; MILLER OIL CO.; BOSCOV'S DEPARTMENT STORE, LLC; and NATIONAL RESTAURANT ASSOCIATION, Plaintiffs, v. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, Defendant.	)	Case No. 1:11-cv-02075 (RJL)

BRIEF OF SENATOR RICHARD J. DURBIN AS *AMICUS CURIAE* IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

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INTEREST OF *AMICUS CURIAE*

Amicus Curiae Senator Richard J. Durbin is the primary author of Section 920 of the Electronic Fund Transfer Act ("EFTA") (15 U.S.C. §1693 *et seq.*) as amended by Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") (Pub. L. No. 111-203, 124 Stat. 1376 (2010)), a provision commonly known as the "Durbin Amendment."[1]

In this case, the Plaintiffs have challenged final regulations issued by the Board of Governors of the Federal Reserve System ("Board") as exceeding the statutory authority given to the Board under the Durbin Amendment. *See Debit Card Interchange Fees and Routing, Final Rule*, 76 Fed. Reg. 43,394 (July 20, 2011) ("Final Rule"). The Plaintiffs have moved that the Court declare the Final Rule to be arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law in violation of the Administrative Procedure Act. *See* Memorandum In Support of Plaintiffs' Motion for Summary Judgment ("Pl. Br.") at 5. The Court's review of the Board's interpretation of the statute is guided by the two-step analysis laid out in *Chevron U.S.A. Inc. v. NRDC*, 467 U.S. 837 (1984). Under *Chevron*, the reviewing court first asks "whether Congress has directly spoken to the precise question at issue," and the court "must give effect to the unambiguously expressed intent of Congress." *Chevron*, 467 U.S. at 842-843. If the statute is silent or ambiguous with respect to the specific issue, the court must determine whether the agency's interpretation is "based on a permissible construction of the statute." *Chevron*, 467 U.S.

[1] *See, e.g.*, Brief *Amici Curiae* of the Clearing House Association L.L.C. et al., which describes EFTA Section 920 as the "Durbin Amendment" throughout the brief. *See also TCF National Bank v. Bernanke*, 643 F.3d 1158 (8th Cir. 2011) (referring to the "Durbin Amendment" throughout).

at 843. The structure, purpose and legislative history of the statute are important under both steps of the *Chevron* analysis.[2]

Senator Durbin crafted the text of the Durbin Amendment and led the effort to secure its enactment, and his views on the statutory structure of the Durbin Amendment and the legislative intent and purpose behind the Amendment will assist the Court in conducting its *Chevron* analysis. Both the Plaintiffs and the Board extensively cite statements made by Senator Durbin in support of their respective arguments in their motions for summary judgment. *See, e.g.*, Pl. Br. at 9, 10, 20, and 53; Defendant's Combined Memorandum of Points and Authorities In Support of its Motion for Summary Judgment and in opposition to Plaintiffs' Motion for Summary Judgment ("Def. Br.") at 19-20, 52-53 and 58. Senator Durbin submits this brief in order to ensure that his statements and views are accurately conveyed and understood.

Senator Durbin agrees with the position of the Plaintiffs that the Final Rule issued by the Board is not in accordance with the plain text and intent of the Durbin Amendment in a number of crucial respects and that the Rule must be revised to comply with the law. This brief elaborates on several ways in which the Final Rule contravenes the Amendment's text and purpose. Further, Senator Durbin submits this brief to rebut arguments made by the Board that have mischaracterized Senator Durbin's statements and intent.

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[2] *See, e.g., Natural Resources Defense Council, Inc. v. Daley*, 209 F.3d 747, 752 (D.C. Cir. 2000) ("Under the first step of *Chevron*, the reviewing court 'must first exhaust the traditional tools of statutory construction to determine whether Congress has spoken to the precise question at issue.' The traditional tools include examination of the statute's text, legislative history, and structure, as well as its purpose…If this search yields a clear result, then Congress has expressed its intention as to the question, and deference is not appropriate.") (citations omitted); *AFL-CIO v. Chao*, 409 F.3d 377, 384 (D.C. Cir. 2005) ("Under *Chevron* Step 2, courts owe deference to an agency's interpretation of a statute it is entrusted to administer. At the same time, when statutory language is ambiguous it is not a foregone conclusion that an agency's interpretation is a reasonable one to which the court must defer. Under *Chevron* Step 2, 'the question for the court is whether the agency's interpretation is based on a permissible construction of the statute' in light of its 'language, structure, and purpose.'") (citations omitted).

BACKGROUND ON THE DURBIN AMENDMENT

In 2010, Congress enacted the Durbin Amendment in order to carefully but firmly rein in the interchange fee collusion that thousands of financial institutions engage in through payment card networks like Visa and MasterCard. The Amendment was motivated by years of Congressional hearings,[3] Government Accountability Office reports,[4] Federal Reserve studies,[5]

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[3] *See, e.g.*, *Hearing on Credit Card Interchange Rates: Antitrust Concerns? Before the S. Comm. on the Judiciary*, 109th Cong. (2006); *Hearing on Credit Card Interchange Fees Before the Antitrust Task Force, H. Comm. on the Judiciary*, 110th Cong. (2007); *Hearing on H.R. 5546, the Credit Card Fair Fee Act, Before the Antitrust Task Force, H. Comm. on the Judiciary*, 109th Cong. (2008); *Hearing on H.R. 2382, the Credit Card Interchange Fees Act of 2009 Before the H. Comm. on Financial Services*, 111th Cong. (2009); *Hearing on H.R. 2695, the Credit Card Fair Fee Act of 2009 Before the H. Comm. on the Judiciary*, 111th Cong. (2010); *Oversight of Federal Payment of Interchange Fees: How to Save Taxpayer Dollars, Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations*, 111th Cong. (2010).

[4] *See, e.g.*, U.S. Gov't Accountability Office, *Credit and Debit Cards: Federal Entities Are Taking Actions to Limit Their Interchange Fees, but Additional Revenue Collection Cost Savings May Exist*, GAO-08-558 (May 2008); U.S. Gov't Accountability Office, *Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges*, GAO-10-45 (Nov. 2009).

[5] *See, e.g.*, Terri Bradford & Fumiko Hayashi, *Developments in Interchange Fees in the United States and Abroad*, Federal Reserve Bank of Kansas City, Apr. 2008, *available at* http://www.kansascityfed.org/Publicat/PSR/Briefings/PSR-BriefingApr08.pdf (stating that "While regulation of interchange fees is still just a point of discussion in the United States, regulation abroad is a reality. In about 20 countries, public authorities have taken actions that limit the level of interchange fees or merchant discount fees. Many of these actions require interchange fees to be set according to cost-based benchmarks, although the cost categories that are eligible for the benchmarks vary by country. In several countries, interchange fees are set at zero."); Robin A. Prager et al., *Interchange Fees and Payment Card Networks: Economics, Industry Developments, and Policy Issues*, Federal Reserve Board Division of Research & Statistics and Monetary Affairs, Finance and Economics Discussion Series, 2009-23, *available at* http://www.federalreserve.gov/pubs/feds/2009/200923/200923pap.pdf (analyzing the structure and economic theory behind the interchange system and discussing various proposals for reform); James McAndrews & Zhu Wang, *The Economics of Two-Sided Payment Card Markets: Pricing, Adoption and Usage*, Federal Reserve Bank of Kansas City, Dec. 2008, http://www.kansascityfed.org/Publicat/RESWKPAP/PDF/RWP08-12.pdf (stating that "privately determined card pricing, adoption and usage tend to deviate from the social optimum, and imposing a ceiling on interchange fees may improve consumer welfare.").

academic articles,[6] and press reports[7] that demonstrated that the interchange fee system was not a properly functioning market. These analyses showed that the interchange fee system was designed and operated by payment card networks and their issuing banks to avoid transparency and competition and to generate high fees that exceeded what could be sustained in a normal competitive market environment The enactment of the Durbin Amendment reflected a bipartisan recognition in Congress that reasonable debit interchange reform was needed to bring transparency, competition and choice to a system that lacked it.[8]

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[6] *See, e.g.,* Fumiko Hayashi, *Payment Card Interchange Fees and Merchant Service Charges – An International Comparison*, Lydian Payments Journal, Jan. 2010, at 6, 11-12, *available at* http://www.pymnts.com/assets/NewFolder/Lydian-Payments-Journal-Volume-1-Issue-3.pdf (finding that "[i]n general, the United States has the highest debit card interchange fees" and that "the United States has the highest interchange fees for both credit and debit cards among the 13 countries where adoption and usage of payment cards are well advanced."); Alan S. Frankel & Allan L. Shampine, *The Economic Effects of Interchange Fees*, 73 Antitrust L.J. 627, 671 (2006) (finding that the interchange fee "acts much like a sales tax, but it is privately imposed and collected by banks, not the government. It significantly and arbitrarily raises prices based not on technologically and competitively determined costs, but through a collective process."); Dennis W. Carlton, *Externalities in Payment Card Networks: Theories and Evidence, Commentary*, The Changing Retail Payments Landscape: What Role for Central Banks, proceedings of a conference held at the Federal Reserve Bank of Kansas City, Nov. 9-10, 2009 at 125, 129, *available at* http://www.kc.frb.org/publicat/pscp/2009/PDF/A1.completeproceedings.pdf (finding that "in seven of the eight countries with the highest debit card usage per capita there is no interchange fee.").

[7] *See, e.g.,* Andrew Martin, *How Visa, Using Card Fees, Dominates a Market*, N.Y. Times, Jan. 4, 2010. ("Competition, of course, usually forces prices lower. But for payment networks like Visa and MasterCard, competition in the card business is more about winning over banks that actually issue the cards than consumers who use them. Visa and MasterCard set the fees that merchants must pay the cardholder's bank. And higher fees mean higher profits for banks, even if it means that merchants shift the cost to consumers.").

[8] For more discussion about how the Durbin Amendment was motivated by concerns with Visa's and MasterCard's enormous market power and unregulated fee-setting in the debit system, *see* Comment Letter of Senator Richard J. Durbin (February 22, 2011) ("Durbin Comment Letter") at 1-4.

The Durbin Amendment as enacted by Congress consists of two main parts. The first part, contained in EFTA Section 920(a), places reasonable constraints on the debit interchange fee-fixing that the nation's largest card-issuing banks permit networks like Visa to perform on their behalf. The second part, contained in EFTA Section 920(b), rescinds several anti-competitive restrictions that card networks had imposed on other participants in the debit system.

I. Section 920(a)

In Section 920(a), Congress established a mandate regarding the legality of debit interchange transaction fees and then carefully crafted a limited set of directives authorizing the Board to effectuate this mandate.

First, Congress established the mandate in Section 920(a)(2) that "[t]he amount of any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction shall be reasonable and proportional to the cost incurred by the issuer with respect to the transaction." The legislative intent behind this mandate was summarized in the Comment Letter submitted by Senator Durbin to the Board in response to the Board's issuance of its draft rulemaking – a document that the Board cited and quoted as authority in its brief. Def. Br. at 52-53, 58. As Senator Durbin's Comment Letter stated:

> The legislative intent behind EFTA 920(a) was to place reasonable constraints on the debit interchange price-setting that card networks like Visa and MasterCard currently perform on behalf of all their issuing banks. As Visa made clear in a November 8, 2010, letter to the Board, "issuers do not in practice set interchange transaction fees; rather, these fees are set by networks". Network setting of interchange fees has negative implications for the efficiency of issuers' card operations and also prevents fee rates from being tempered by competitive market forces. In network-established interchange fee systems, there is no competition between issuing banks over the fees they receive, and each bank that issues the network's cards receives exactly the same network-established fee no matter how efficiently or inefficiently that bank processes transactions or prevents fraud. Also, it has often been observed that competition between networks does not lead to downward pressure on interchange rates because networks compete to attract issuers and do so by raising interchange fees.

> It is obvious why the current interchange fee system was set up by the banks and the dominant debit card networks Visa and MasterCard. The system is lucrative for issuing banks, who receive tens of billions per year in high fees that are not tempered by competitive market forces and that are not linked to any particular bank's actual costs. It also benefits the card networks, because they are paid each time a card is swiped and high interchange fees mean banks will issue more cards. But the system is unfair to consumers, who pay tens of billions per year in hidden fees passed on to them in the form of higher retail prices. And it is unfair to merchants, who cannot negotiate interchange fees and who can no longer realistically refuse to accept the dominant card networks despite constant fee increases.
>
> Many have argued that interchange fees should be prohibited in the debit system as they are in the checking system. Congress did not go quite that far, instead requiring that any interchange transaction fee (carefully defined to only include fees that are established, charged or received by a network for the purpose of compensating an issuer) must be reasonable and proportional to the cost incurred by the issuer with respect to the transaction. This means that if an issuing bank is going to let a card network set the rate for the fee that the issuing bank will receive for a debit transaction, Congress has decided that the network-established fee must be reasonable and proportional to the cost the issuer incurred with respect to the transaction.

Durbin Comment Letter at 5-6 (internal citations omitted).

After laying out its mandate in Section 920(a)(2), Congress then directed the Board in Section 920(a)(3)(A) to prescribe regulations "to establish standards for assessing whether the amount of any interchange transaction fee described in paragraph (2) is reasonable and proportional to the cost incurred by the issuer with respect to the transaction." In Section 920(a)(3)(B) Congress also gave the Board the authority to "require any issuer (or agent of an issuer) or payment card network to provide the Board with such information as may be necessary to carry out the provisions of this Subsection" so that the Board would be able to access cost information that had previously been known only to issuers and networks[9] and to use this information in crafting the standards as Congress directed.

[9] The financial services industry had historically refused to share information about its actual costs of card operations, even refusing to provide this information to the Government

Congress next gave the Board two clear and specific considerations in Section 920(a)(4) for the Board to take into account when carrying out Section 920(a)(3)(A)'s requirement "to establish standards for assessing whether the amount of any debit interchange transaction fee described in paragraph (2) is reasonable and proportional to the cost incurred by the issuer with respect to the transaction." First, in Section 920(a)(4)(A), Congress instructed the Board to "consider the functional similarity between (i) electronic debit transactions; and (ii) checking transactions that are required within the Federal Reserve bank system to clear at par."[10] Second, in 920(a)(4)(B), Congress authorized the Board to "distinguish between (i) the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction, which cost shall be considered under paragraph (2); and (ii) other costs incurred by an issuer which are not specific to a particular electronic debit transaction, which costs shall not be considered under paragraph (2)…"

The legislative intent behind Section 920(a)(4) is summarized in Senator Durbin's Comment Letter as follows:

Accountability Office. *See* U.S. Gov't Accountability Office, *Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges*, GAO-10-45 at 23 (Nov. 2009) (stating that "Information on the amount of revenues larger financial institutions collect from interchange fees and how those revenues compare with their costs of card operations and rewards programs is limited. We were not able to obtain data from the largest card issuers about their revenues, profits, or expenses to compare interchange fee revenues with expenses.").

[10] Senator Durbin explained the rationale for Section 920(a)(4)(A)'s requirement for the Board to include this consideration in the Board's standards as follows: "Debit card transactions are fundamentally different from credit card transactions. All that happens in a debit card transaction is you deduct money from your bank account. It is akin to writing a check. That is why debit cards are advertised as check cards. Right now in the United States there are zero transaction fees deducted when you use a check. The Federal Reserve does not allow transaction fees to be charged for checks. But when it comes to debit cards, Visa and MasterCard charge high interchange fees just as they do for credit. Why? Because they can get away with it. There is no regulation, there is no law, there is no one holding them accountable." 156 Cong. Rec. S3696 (daily ed. May 13, 2010) (statement of Sen. Richard Durbin).

> In determining the appropriate cost considerations for the Board to keep in mind when crafting its standards, Congress limited the Board's consideration to "the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction" because Congress intended to create a closer equivalency between the debit card system and the checking system in which transactions are regulated to clear at par. In so limiting network-established debit interchange fees to those incremental authorization, clearance and settlement costs, the new law will incentivize issuers to manage all other costs of their debit card operations efficiently. This stands in stark contrast to the current system of unregulated network-established fees, in which inefficient and efficient issuers receive the same high fees.[11]

Durbin Comment Letter at 6 (internal citations omitted).[12]

After the Durbin Amendment established the mandate in Section 920(a)(2) and the directives to the Board in (a)(3)(A) and (a)(4), the amendment went on to authorize a limited fraud prevention adjustment to the base interchange standards in (a)(5), delineate exceptions to interchange transaction fee regulation in (a)(6) and (7), and carefully prescribe the authority given to the Board with respect to network fees in (a)(8).

Section 920(a)(5) authorizes the Board to "allow for an adjustment to the fee amount received or charged by an issuer under paragraph (2)" if the issuer complies with standards established by the Board that demonstrate that the issuer is taking effective steps to reduce the occurrence and cost of debit fraud, and if the issuer demonstrates that the adjustment it seeks is limited to those reasonably necessary fraud prevention costs. Notably, Congress explicitly

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[11] Senator Durbin pointed out in a footnote on this page of his Comment Letter that Section 920(a)(2) and (a)(3)(A) only regulate interchange transaction fees as defined by the amendment, and noted that "issuing banks can, do, and will continue to charge many other types of fees which are not regulated by the amendment, although unlike interchange fees those other fees are currently set in a competitive market environment." Durbin Comment Letter at 6.

[12] *See also* 156 Cong. Rec. S5925 (daily ed. July 15, 2010) (statement of Sen. Richard Durbin) ("Paragraph (a)(4) makes clear that the cost to be considered by the Board in conducting its reasonable and proportional analysis is the incremental cost incurred by the issuer for its role in the authorization, clearance, or settlement of a particular electronic debit transaction, as opposed to other costs incurred by an issuer which are not specific to the authorization, clearance, or settlement of a particular electronic debit transaction.").

directed the Board in Section 920(a)(5)(A)(ii)(I) to design standards "to ensure that any fraud-related adjustment of the issuer is limited to the amount described in clause (i)."[13]

Section 920(a)(6) exempts from interchange fee regulation those card-issuing financial institutions that have assets of less than $10 billion. Section 920(a)(7) exempts from interchange fee regulation debit cards provided pursuant to a government-administered payment program and reloadable prepaid debit cards so long as certain cardholder fees are not charged (overdraft fees and fees for first monthly in-network ATM withdrawals).

In Section 920(a)(8), Congress gave the Board limited authority to prescribe regulations relating to network fees (defined in Section 920(c)(10) as "any fee charged and received by a payment card network with respect to an electronic debit transaction, other than an interchange transaction fee"). That authority is expressly limited in Section 920(a)(8)(B) to nothing more than regulations "to ensure that (i) a network fee is not used to directly or indirectly compensate an issuer with respect to an electronic debit transaction; and (ii) a network fee is not used to circumvent or evade the restrictions of this subsection and regulations prescribed under such subsection." This narrow authority is the only authority Congress granted the Board to prescribe regulations regarding network fees.

II. Section 920(b)

Section 920(b) of the Durbin Amendment prohibits certain anti-competitive restrictions that card networks had imposed on merchants.

Several of these prohibitions did not require implementing regulations by the Board. For example, Section 920(b)(2) prevents networks from penalizing merchants who offer discounts

[13] The text of clause (i) provides that "such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions involving that issuer." 15 U.S.C. § 1693o-2(a)(5)(A)(i).

for the use of cash, check or debit as a method of payment, and Section 920(b)(3) prohibits networks from penalizing merchants who set a $10 credit card minimum or from penalizing universities and Federal agencies who set a maximum limit on credit card transactions.

In Section 920(b)(1)(A) Congress directed the Board to prescribe regulations providing that a network or issuer cannot restrict the number of networks on which an electronic debit transaction may be processed to one exclusive network or to two networks which are affiliated with each other. As Senator Durbin stated in his Comment Letter, "[t]he intent behind this provision was to inhibit the continued consolidation of the dominant debit networks' market power and to ensure competition and choice in the debit network market." Durbin Comment Letter at 11. Section 920(b)(1)(B) then directs the Board to prescribe regulations providing that a network or issuer cannot inhibit the ability of a person who accepts debit cards to direct the routing of electronic debit transactions over any network that may process such transactions. As Senator Durbin pointed out, this provision was essential to ensure the effectiveness of the non-exclusivity provision in Section 920(b)(1)(A). *See id.* at 12.

SUMMARY OF ARGUMENT

The enactment of the Durbin Amendment in July 2010 represented a landmark reform of the interchange fee system. Through the Durbin Amendment, Congress established a mandate that conditioned the legality of regulated interchange transaction fees upon a reasonable and proportional relationship to the cost incurred by the issuer with respect to the electronic debit transaction for which the fee was charged or received. Congress then carefully crafted a limited set of directives authorizing the Board to effectuate this mandate. This mandate and the directives Congress gave to the Board were clearly articulated in the Durbin Amendment's text and were reinforced by Senator Durbin's statements of legislative intent. Recognizing this, the

Board issued a draft rulemaking[14] in December 2010 that proposed to implement the Amendment in a way that was largely consistent with its plain text as well as its clearly expressed purpose. The Board's draft rulemaking was centered around a proposed 12 cent debit interchange fee cap for large regulated issuers, a standard the Board based on an issuer's per-transaction variable costs of authorization, clearance and settlement ("ACS"). *See* 76 Fed. Reg. at 43,424.

The nation's financial services industry expressed outrage with the Board's draft rulemaking and launched an aggressive lobbying campaign to weaken the draft rule and secure a final rule that preserved more of the industry's existing interchange revenue stream (estimated at $16.2 billion for 2009[15]). Even though a bipartisan majority in Congress had already considered and rejected the arguments of the financial services industry in voting to enact the Durbin Amendment, the industry's campaign succeeded in influencing the Board to issue a Final Rule in June 2011 that deviated from the plain text and intent of the statute that Congress had enacted.[16] The Board appears to have shaped its final rule in an effort to accomplish two of the Board's own policy goals: (1) making the Final Rule significantly more generous to issuing banks than the draft rulemaking, which it accomplished by permitting regulated issuers to receive an

[14] *Debit Card Interchange Fees and Routing, Notice of Proposed Rulemaking*, 75 Fed. Reg. 81,722 (Dec. 28, 2010) ("NPRM").

[15] Def. Br. at 4.

[16] *See* Statement of Frank Keating, President and CEO of the American Bankers Association, *Who won and who lost with the Federal Reserve's final debit interchange rule?*, Am. Bankers Ass'n Washington Perspective, July 1, 2011, *available at* http://durbin.senate.gov/public/ index.cfm/files/serve? File_id=68d6ba0d-0238-4d5f-b9a8-a38f782a24fb (stating "I am pleased that the Fed took what action it could to ease the rule's impact on banks. . . . It's clear to me that the aggressive six-month campaign that ABA, state bankers associations and bankers waged on this issue had a real bottom-line impact . . . the Fed heard enough concerns and credible arguments from banks that they practically doubled their originally proposed 12-cent cap.").

interchange fee amounting to 21 cents plus an *ad valorem* component of 5 basis points plus a one cent fraud prevention adjustment on each debit transaction; and (2) splitting the baby between banks and merchants, which it accomplished by "setting a fee that is approximately half of the 44 cents per transaction average interchange fee for all debit card transactions merchants were paying prior to promulgation of the Final Rule." Def. Br. at 33.

In its efforts to accommodate the banks, the Board's Final Rule failed in several respects to follow the law. As the Plaintiffs have correctly argued, the Board's final rulemaking exceeded the statutory authority that Congress gave the Board. Additionally, this brief highlights how several cost considerations that the Board included in its final interchange fee standard were expressly precluded by the Durbin Amendment's text and intent. Finally, the brief points out how the Board failed to follow the plain language and intent of the Durbin Amendment's non-exclusivity provision and how the Board mischaracterized Senator Durbin's statements with respect to that provision.

ARGUMENT

I. THE BOARD EXCEEDED ITS STATUTORY AUTHORITY UNDER SECTION 920 IN ITS FINAL RULEMAKING.

The Durbin Amendment carefully and clearly delineated the Board's authority with respect to the setting of interchange transaction fee standards. Unfortunately, the Board has attempted in its Final Rule to exercise discretion that Congress has not given it and to assert authority it does not have. The Board's inclusion of certain issuer costs within its interchange transaction fee standards is clearly inconsistent with the Durbin Amendment's plain text, structure, legislative history and purpose.

A. Congress Did Not Grant the Board the Authority to Consider and Include an Unspecified Universe of Issuer Costs in the Interchange Fee Standards Required under Section 920(a).

In Section 920(a)(2), Congress expressly conditioned the legality of regulated interchange transaction fees upon a reasonable and proportional relationship to the cost incurred by the issuer with respect to the electronic debit transaction for which the fee was charged or received. In Section 920(a)(3)(A), Congress authorized the Board to establish standards for assessing whether the amount of any interchange transaction fee is reasonable and proportional to the cost incurred by the issuer with respect to the transaction. Congress then provided the Board with Section 920(a)(4)'s specific directives on how to effectuate the mandate in Section 920(a)(2) and to prescribe appropriate regulations pursuant to (a)(3)(A). Notably, in Section 920(a)(4)(B)(i), Congress directed that "the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction" be considered under the mandate Congress laid out in Section 920(a)(2). Senator Durbin explained the purpose and impact of Section 920(a)(4) by stating that:

> Paragraph (a)(4) makes clear that the cost to be considered by the Board in conducting its reasonable and proportional analysis is the incremental cost incurred by the issuer for its role in the authorization, clearance, or settlement of a particular electronic debit transaction, as opposed to other costs incurred by an issuer which are not specific to the authorization, clearance, or settlement of a particular electronic debit transaction.

156 Cong. Rec. S5925 (daily ed. July 15, 2010) (statement of Sen. Richard Durbin). The plain text of the statute and Senator Durbin's legislative history make clear that the singular cost the Board was expressly authorized under (a)(4)(B) to consider under (a)(2)'s reasonable and proportional analysis and to include in its regulations under (a)(3)(A) was the incremental ACS cost of a particular electronic debit transaction – and no other cost. By attempting to include in

its Final Rule other cost considerations that are not mentioned in the statute's text, the Board attempts to claim regulatory authority that Congress did not give it.

The Board argues that Congress "chose language that left some costs unaccounted for" in the text of Section 920(a)(4)(B), and that the statute's "silence" with respect to this "significant third category of costs" creates an ambiguity that the Board claims discretion to resolve by including many of these costs in its interchange fee standards. Def. Br. at 18, 20. In making this argument, the Board relies on a tortured parsing of statutory language that ignores Congress's intent and defies the Amendment's purpose.

Congress knew prior to the enactment of the Durbin Amendment that the financial services industry had long sought to justify its exorbitant interchange rates by claiming those rates were needed to cover a broad and ever-shifting panoply of bank costs.[17] Congress also knew that if it permitted the Board to establish a "reasonable and proportional standard" that was linked to an unspecified and potentially boundless universe of costs, then any interchange rate, no matter how exorbitant, could potentially be justified as reasonable and proportional. Thus,

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[17] *See, e.g.*, Letter from Joseph W. Saunders, Chairman & CEO of Visa, to Senators Durbin, Kohl, Snowe & Specter, June 3, 2008, at 1, *available at* http://durbin.senate.gov/public/index.cfm/files/serve?File_id=85c0f9c3-5f33-456e-ba3e-c2e9681756eb ("[I]t is important to make clear that interchange was not designed to recoup costs but as a transfer of value generating a form of revenue to card-issuing financial institutions. Visa's interchange rates are not set at levels equal to or based on overall costs. If this were the case, interchange would be significantly higher as aggregate issuer costs overwhelm the level of interchange."); U.S. Gov't Accountability Office, *Rising Interchange Fees Have Increased Costs for Merchants, but Options for Reducing Fees Pose Challenges*, GAO-10-45 (Nov. 2009), at 21 ("Issuers report that the revenue they receive from interchange fees is used to cover a variety of costs in their card programs. . . . Although issuers incur costs for offering cards, concerns remain about the extent to which interchange fee levels closely relate to the level of card program expenses or whether they are set high so as to increase issuer profits."); *See also* Shareholder Letter from Jamie Dimon, Chairman and CEO JPMorgan Chase, at 24, Apr. 4, 2011, *available at* http://files.shareholder.com/downloads/ONE/1279744849x0x458384/6832cb35-0cdb-47fe-8ae4-1183aeceb7fa/2010_JPMC_AR_letter_.pdf (arguing that banks need debit interchange fees to pay for the "fixed costs of servicing checking accounts and debit cards" such as "the costs of ATMs and branches.").

the effectiveness of the Durbin Amendment's "reasonable and proportional" mandate in reducing the high interchange rates fixed by Visa and MasterCard necessarily depended on carefully limiting the nature of the costs that the Board could include in the interchange fee standards.

Congress in Section 920(a)(4)(B)(i) wrote language that expressly authorized the Board to consider incremental ACS cost under Section 920(a)(2)'s reasonable and proportional analysis. As made clear in Senator Durbin's floor statement, Congress did not intend for other unspecified costs to be considered under (a)(2). *See* 156 Cong. Rec. S5925 (daily ed. July 15, 2010) (statement of Sen. Richard Durbin). The fact that Congress did not intend the Board to allow consideration of other unspecified costs in its interchange fee standards is reflected by the reporting requirement Congress created in Section 920(a)(3)(B). This reporting requirement directed the Board to report solely on information it collected "concerning the costs incurred…in connection with the authorization, clearance or settlement of electronic debit transactions" and not other costs. If Congress had intended to authorize the Board to also consider under (a)(2)'s analysis an additional, unbounded and unspecified universe of costs "that are specific to a particular electronic debit transaction but that are not incremental ACS costs," as the Board claims, Congress would have written language in the statute expressly directing the Board to consider that universe of costs and would have directed the Board in (a)(3)(B) to report on its findings concerning those costs.

The Board, by adopting a counterintuitive statutory construction and including in its final interchange fee standards costs that Congress neither authorized nor intended the Board to include, has exceeded the authority given to it under the Durbin Amendment. This stands in stark contrast to the Board's proposals in its NPRM[18] which Senator Durbin commended in his Comment Letter as being consistent with the statute's text and intent. *See* Durbin Comment Letter at 3. In order for its Final Rule to comply with the text and intent of the statute, the Board would be well served to return to the analysis and proposed interchange fee standards that it presented in the NPRM.

B. The Board's Inclusion of Certain Items in Allowable Costs Contravenes the Plain Language and Legislative Intent of the Durbin Amendment.

As discussed above, the Board acted outside its statutory authority by including within its interchange standards costs other than those costs Congress expressly authorized the Board to consider in Section 920(a)(4)(B)(i). The Plaintiffs and the Board also argue in their respective briefs about the propriety of the Board's inclusion of four particular types of costs in its final interchange fee standard. For a number of reasons, the Board's inclusion of these costs is not authorized by the Durbin Amendment and is inconsistent with the Amendment's plain language and intent.

1. Fixed Costs

The Board's Final Rule included in its interchange fee standard "fixed" authorization, clearance and settlement costs. 76 Fed. Reg. at 43,429. However, Congress did not give, nor did it intend to give, the Board authority under (a)(4)(B)(i) or under any other part of the statute to include costs that are not "incremental" ACS costs incurred for the issuer's role in a particular electronic debit transaction.

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[18] *See* 75 Fed. Reg. at 81,734 ("After considering several options for the costs that may be taken into account in setting interchange transaction fees ('allowable costs'), the Board proposes such costs be limited to those associated with authorization, clearing, and settlement of a transaction. This formulation includes only those costs that are specifically mentioned for consideration in the statute.").

The Board applied the law properly in its NPRM when it proposed in a section entitled "Cost Measurement" that the interchange fee standard should cover average variable cost and that "[t]his measure would *not* consider costs that are common to all debit card transactions and could never be attributed to any *particular* transaction (*i.e.*, fixed costs), even if those costs are specific to debit card transactions as a whole." 75 Fed. Reg. at 81,735-6 (emphasis in original). As Senator Durbin stated in his Comment Letter about the NPRM, "the Board's proposed calculation of incremental cost as average variable cost in its 'Cost Measurement' analysis is consistent with the legislative intent, and the inclusion of other costs in this analysis would be inconsistent with the language and intent of EFTA Section 920." Durbin Comment Letter at 7 (internal citations omitted).[19]

Also, the Board claims in its brief that its conflation of variable and fixed ACS costs is justified because "distinguishing between fixed and variable ACS costs is not feasible in practice." Def. Br. at 41. However, this claim is belied by the fact that Board drew such a distinction in its NPRM and was able to segment out data specifically on variable cost. As the Board stated in the NPRM:

> To determine an appropriate value for a cap, the Board used data from responses to the card issuer survey described earlier. The Board used data on transaction volumes and <u>the variable cost of authorization, clearing and settlement</u> (the allowable costs under an issuer-specific determination) to compute an issuer's per-transaction cost.

[19] *See also* 156 Cong. Rec. S5925 (daily ed. July 15, 2010) (statement of Sen. Richard Durbin) ("Paragraph (a)(4) makes clear that the cost to be considered by the Board in conducting its reasonable and proportional analysis is the incremental cost incurred by the issuer for its role in the authorization, clearance, or settlement of a particular electronic debit transaction, as opposed to other costs incurred by an issuer which are not specific to the authorization, clearance, or settlement of a particular electronic debit transaction.").

75 Fed. Reg. at 81,737 (emphasis added). In order to make its Final Rule consistent with the Durbin Amendment's text and intent, the Board should return to the analysis it applied in the NPRM.

2. Transaction Monitoring

As the Board admitted in its Final Rule, transaction monitoring is "fraud-prevention activity." 76 Fed. Reg. at 43,397. The Durbin Amendment clearly delineated the Board's authority to include fraud prevention costs in its interchange regulations, and made clear that the Board is not authorized to include the costs of "fraud prevention" activity like transaction monitoring within the base interchange standards the Board established pursuant to Section 920(a)(3)(A).

Under Section 920(a)(5)(A), the Board is permitted to make an adjustment to interchange fee amounts involving "an allowance for costs incurred by the issuer in preventing fraud." However, if such an adjustment for fraud prevention costs is to be permissible, Section 920(a)(5)(A)(ii) requires that the issuer must also be in compliance with standards established by the Board under 920(a)(5)(B) which must include (a)(5)(A)(ii)(II)'s effectiveness requirement. The Board's Final Rule, by including costs for a "fraud-prevention activity" in the base interchange fee standard, improperly adjusts interchange fee amounts for every issuer in the network regardless of whether the issuer complies with the fraud-related standards established by the Board under Section 920(a)(5)(B).

Congress explicitly linked the allowance of a fee adjustment for fraud prevention activity with Section 920(a)(5)(A)(ii)(II)'s requirement that the issuer also be compliant with standards that "require issuers to take effective steps to reduce the occurrence of, and costs from, fraud in relation to electronic debit transactions." (emphasis added). Congress did so for the simple reason that it did not want to reward issuers with an interchange fee increase to cover fraud prevention costs that were not effective in reducing fraud. But the Board's Final Rule rewards all issuers with an upward interchange fee adjustment for transaction monitoring even if an issuer is entirely ineffective in preventing fraud.

Senator Durbin's discussion of Section 920(a)(5) on the Senate floor reinforced the clear language of that provision:

> Paragraph (5) of subsection (a) provides that the Federal Reserve Board may allow for an adjustment of an interchange transaction fee amount received by a particular issuer if the adjustment is reasonably necessary to make allowance for the fraud prevention costs incurred by the issuer seeking the adjustment in relation to its electronic debit transactions, provided that the issuer has demonstrated compliance with fraud-related standards established by the Board. The standards established by the Board will ensure that any adjustments to the fee shall be limited to reasonably necessary costs and shall take into account fraud-related reimbursements that the issuer receives from consumers, merchants, or networks. The standards shall also require issuers that want an adjustment to their interchange fees to take effective steps to reduce the occurrence of and costs from fraud in electronic debit transactions, including through the development of cost-effective fraud prevention technology.
>
> It should be noted that any fraud prevention adjustment to the fee amount would occur after the base calculation of the reasonable and proportional interchange fee amount takes place, and fraud prevention costs would not be considered as part of the incremental issuer costs upon which the reasonable and proportional fee amount is based. Further, any fraud prevention cost adjustment would be made on an issuer-specific basis, as each issuer must individually demonstrate that it complies with the standards established by the Board, and as the adjustment would be limited to what is reasonably necessary to make allowance for fraud prevention costs incurred by that particular issuer.

156 Cong. Rec. S5925 (daily ed. July 15, 2010) (statement of Sen. Richard Durbin) (emphasis added). Senator Durbin further elaborated on the legislative intent of Section 920(a)(5) in his Comment Letter to the Board, stating:

> The current system of network-established interchange fees creates precisely the wrong incentives for issuers when it comes to fraud prevention. Under the current system, all issuing banks in a network receive the same network-established interchange fee rates. This provides little incentive for issuers to minimize fraud,

> since they will receive the same interchange fee whether there is significant fraud or no fraud associated with their debit transactions…In contrast to the current inefficient system, EFTA Section 920(a)(5) will incentive regulated issuing banks to reduce fraud by allowing banks that take successful fraud prevention steps to receive increased interchange fees.

Durbin Comment Letter at 9 (emphasis added). This legislative intent reinforces the clear statutory language of Section 920(a)(5) that forecloses fraud prevention adjustments of interchange fee amounts without an issuer's having complied with standards requiring effective prevention of fraud. Thus, the Board's inclusion of transaction monitoring costs in the base interchange standard is impermissible.

3. Fraud Losses

The Board's Final Rule includes fraud losses as allowable costs in the interchange fee standard. *See* 76 Fed. Reg. at 43,431. This is clearly prohibited by the plain language of the Durbin Amendment, since the Amendment carefully limited the situations in which it empowered the Board to make fraud-related adjustments. Section 920(a)(5)(A)(ii)(I) directs the Board to establish standards "to ensure that any fraud-related adjustment of the issuer is limited to the amount described in clause (i)." Clause (i) only discusses allowance for "costs incurred by the issuer in preventing fraud," and does not make allowance for fraud losses.

The Board claims in its brief that "[t]here is no language in sections 920(a)(2), (3)(A) and (4)(B) that suggests that the Board may not include an adjustment for fraud losses in the standard for interchange fees that are reasonable and proportional to costs" and that "The Board was well within its discretion under the statute in including an *ad valorem* adjustment for fraud losses in allowable costs." Def. Br. at 46-47 (emphasis added). But with these statements the Board has conceded that its inclusion of fraud losses in the interchange fee standards is an "adjustment", and Section 920(a)(5)(A)(ii)(I) is crystal clear that "any" fraud-related "adjustment" is limited to the amount described in 920(a)(5)(A)(i), *i.e.*, fraud prevention costs. Thus, the Board is flatly prohibited by the plain language of the Durbin Amendment from making any adjustment that covers fraud losses as opposed to fraud prevention costs, and the *ad valorem* adjustment for fraud losses that the Board included in its Final Rule cannot stand.

4. Network Processing Fees

The Board in its Final Rule also exceeded its statutory authority by including "network processing fees (e.g., switch fees)" in the interchange fee standard. 76 Fed. Reg. at 43,430.

Section 920(c)(10) of the Durbin Amendment defines "network fee" as "any fee charged and received by a payment card network with respect to an electronic debit transaction, other than an interchange fee." Congress did not give the Board authority to prescribe regulations regarding network fees in any part of the Durbin Amendment except for Section 920(a)(8), which states that "The Board may prescribe regulations…regarding any network fee." However, Section 920(a)(8)(B) expressly limits the grant of authority Congress gave the Board over network fees to only allow the Board to issue regulations regarding network fees in two discrete situations: "to ensure that (i) a network fee is not used to directly or indirectly compensate an issuer with respect to an electronic debit transaction; and (ii) a network fee is not used to circumvent or evade the restrictions of this subsection and regulations prescribed under this subsection." [20]

[20] Note that the Board uses the term "network processing fee" and "network fee" interchangeably in its Final Rule. *See, e.g.*, 76 Fed. Reg. at 43,430. Also, the Board defines switch fees in the Final Rule and equates them with "network fees", stating that "[s]witch fees are charged by the network to acquirers and issuers to compensate the network for its role in processing the transaction" and noting that "[a] variety of other <u>network fees</u>, such as membership fees and licensing fees, may be collected by the network from the issuer or acquirer." 76 Fed. Reg. at 43,396 (emphasis added).

The Board simply has not been given the authority by Congress to issue any regulations regarding network fees that do not fall within those two specified situations. Further, the Board's inclusion of network fees in the amount of interchange fees that issuers receive on debit transactions directly contradicts Congress's directive in Section 920(a)(8)(B)(i) that the Board was only authorized to prescribe regulations regarding network fees to ensure that a network fee is <u>not</u> used to compensate an issuer with respect to a debit transaction.

The statute is explicit in Section 920(a)(8) about the Board's authority to issue regulations concerning network fees, and the Board has both exceeded that authority and run afoul of Congress's explicit directive in Section 920(a)(8)(B)(i). The Board's inclusion of network processing fees cannot stand.

C. The Board Incorrectly Claims That Its Interpretation of Section 920(a) Achieves the Statute's Purpose By Setting a Fee That Is Approximately Half of the 44 Cents Per Transaction Average Interchange Fee.

The Board is mistaken in its claim that its "interpretation achieves the statutory purpose of establishing an interchange fee standard that is 'reasonable' and 'proportional' to cost by setting a fee that is approximately half of the 44 cents per transaction average interchange fee for all debit card transactions merchants were paying prior to promulgation of the Final Rule." Def. Br. at 33. This claim reflects an apparent lack of understanding by the Board about the nature of interchange fees, the impact of its Final Rule, and the purpose of the Durbin Amendment.

As the Board earlier acknowledged in its NPRM, debit interchange transaction fees have for years been established by networks as a combination of an *ad valorem* (*i.e.*, percentage of the value of transaction) fee component plus a flat fee component. 75 Fed. Reg. at 81,724.[21] This

[21] As the Board stated in the NPRM "Beginning around 2000, many PIN debit networks incorporated an *ad valorem* (*i.e.*, percentage of the value of the transaction) component to their interchange fees, with a cap on the total amount of the fee for each transaction." 75 Fed. Reg. at

fee structure meant that before the Final Rule took effect, small ticket (*i.e.*, small dollar) debit transactions were typically assessed interchange fees that amounted to significantly less than 44 cents.[22] However, by setting a high fee cap that far exceeds the customary fees levied on small ticket transactions, the Fed has given its regulatory blessing to the setting of interchange rates by Visa and MasterCard that are over three times larger than rates previously charged on small dollar transactions. After the issuance of the Final Rule, first MasterCard and then Visa raised their small ticket interchange rates for regulated issuers to the Final Rule's maximum allowable level, increasing fees significantly for small ticket transactions.[23]

The statutory purpose of the Durbin Amendment's fee regulation has been clearly expressed by Senator Durbin:

> Our language will help every single Main Street business that accepts debit cards keep more of their money, which is a savings they can pass on to their consumers. Every grocery store, every convenience store, flower shop, and every restaurant will be able to reduce the fees they paid to the big banks for debit card transactions….It is not just businesses that will benefit from the amendment. Charities will benefit. Think about that. Charities that accept donations by debit

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81,724. Also, the Board stated that "[i]n general, interchange fees for signature debit networks, like those of credit card networks, combine an *ad valorem* component with a fixed fee component." *Id.*

[22] *See* International Franchise Association & National Council of Chain Restaurants Comment Letter, at 8 (Feb. 22, 2011), *available at* http://www.federalreserve.gov/SECRS/2011/March/20110323/R-1404/R-1404_022211_67493_559268623510_1.pdf (noting that "Under current published Visa and MasterCard Small-Ticket Transaction debit interchange fee rates (both set at 1.55% + 4 cents), a $5 transaction incurs 11.75 cents in interchange transaction fees. . . . Similarly, under the same Visa and MasterCard Small-Ticket Transaction debit interchange fee rates, a $1 transaction incurs 5.6 cents in interchange transaction fees. . . .").

[23] *See* Digital Transactions News, *Applying the Durbin Maximum, Visa and MasterCard Could Squash Small Tickets*, Sept. 27, 2011, http://www.digitaltransactions.net/news/story /3217 ("The new schedules will raise merchants' acceptance costs considerably when a customer presents a card from a big bank to pay for a small purchase. For example, under the April rates, a merchant on a $2 sale for a cup of coffee currently pays 7.1 cents when either a Visa or MasterCard debit card is presented. Now that cost will more than triple to 23 cents, assuming the Fed approves the proposed 1-cent fraud fee. On an $8 sale, the cost will increase 59%.").

> cards will see a savings. Universities will save money on card fees, and so will public agencies, such as your local motor vehicle commission in your home state, public transit agencies, and even the U.S. Postal Service.

156 Cong. Rec. S4839 (daily ed. June 10, 2010) (statement of Sen. Richard Durbin). Senator Durbin's statement on the Senate floor makes plain Congress's intent that under the Durbin Amendment each merchant, charity, university and government agency that accepts debit cards should see fees lowered on each transaction involving debit cards issued by large regulated issuers. But because of the misguided nature of the Board's Final Rule, that has not happened. Contrary to the Board's claim that its interpretation gives effect to the "purpose" of the statute, we have ended up with an absurd situation where the Board's Final Rule has approved the charging of significantly higher interchange rates for small ticket transactions, and has even blessed the charging of a 22 cent interchange fee on the debit card purchase of a 10 cent pencil.

Further, the Board has crafted a Final Rule that twists and tortures the plain meaning and clear intent of the Durbin Amendment in an apparent effort to split the baby between big banks and merchants and set a fee "that is approximately half of the 44 cents per transaction average." Def. Br. at 33. But Congress neither instructed nor empowered the Board to impose its own policy judgments and engage in a "line-drawing exercise" between the low fee wishes of merchants and the high fee desires of the banks, as the Board appears to believe. *Id.* Congress had made its own policy determination that the Durbin Amendment was needed as "a response to price fixing by Visa and MasterCard." 156 Cong. Rec. S3589 (daily ed. May 12, 2010) (statement of Sen. Richard Durbin). Congress knew that Visa and MasterCard are the dominant fee-setting entities for debit card transactions, which are the most frequently used form of noncash payment in the United States, and that a significant body of literature had shown that inefficiency is subsidized and competition is avoided when a network duopoly centrally sets fees on behalf of thousands of issuing banks.[24] Congress had also heard from consumer groups who noted that consumers ultimately bear the cost of subsidizing the interchange system and asserted that consumers would benefit from the Durbin Amendment's reforms.[25] Congress's goals were to enhance competition, transparency and choice in the debit system and squeeze out inefficiencies by reducing network-fixed interchange fee rates to cover only a limited measure of incremental ACS cost, thereby compelling large issuers to compete against each other to manage their other costs more efficiently. Further, as Congress was aware, past experience in this country[26] and present examples in other countries[27] demonstrate that banks can easily offer debit card services without the subsidy of unreasonably high interchange fees – and Congress was not

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[24] *See supra* notes 3-7.

[25] *See, e.g.,* 156 Cong. Rec. S3698 (daily ed. May 13, 2010) (letter from Americans for Financial Reform) (Americans for Financial Reform, a coalition including over "250 consumer, civil rights, investor, retiree, community, labor, religious and business groups as well as Nobel Prize-winning economists[,] . . . supports the Durbin Reasonable Fees and Rules for Payment Card Transactions Amendment #3989 because it is good for merchants and good for consumers."); *Oversight of Federal Payment of Interchange Fees: How to Save Taxpayer Dollars, Before the Subcomm. on Financial Services and General Government of the S. Comm. on Appropriations,* 111th Cong. at 2, 5 (June 16, 2010) (testimony of Edmund Mierzwinski, Consumer Program Director, U.S. Public Interest Research Group) ("All consumers, even those who pay with cash and checks, pay more at the store and more at the pump because these interchange fees are passed on in the overall cost of goods sold…[The Durbin Amendment] will have a positive effect.").

[26] *See* Martin, *supra* note 7 ("Fees were not an issue when debit cards first gained traction in the 1980s. The small networks that operated automated teller machines, like STAR, Pulse, MAC and NYCE, issued debit cards that required a PIN. MasterCard had its own PIN debit network, called Maestro. Merchants were not charged a fee for accepting PIN debit cards, and sometimes they even got a small payment because it saved banks the cost of processing a paper check. That changed after Visa entered the debit market.").

[27] *See e.g.,* Carlton, *supra* note 6 (finding that "in seven of the eight countries with the highest debit card usage per capita there is no interchange fee."); Testimony of Edmund Mierzwinski, *supra* note 25, at 7 **(**"As a recent European Commission decision detailed, numerous countries operate payment systems without the use of interchange fees. In those countries the ultimate costs of these systems is modest and the systems operate quite efficiently.").

persuaded by the financial services industry's arguments to the contrary. In short, Congress made its own policy determinations in crafting the Durbin Amendment, and Congress tasked the Board to follow the law Congress passed.

The NPRM was far truer to the statutory purpose of the Durbin Amendment than the Final Rule, which is why Senator Durbin commended the Board in his Comment Letter on the NPRM. Senator Durbin said "Overall, I believe the Board attempted to craft the NPRM in a way that adheres to the facts the Board has learned and to the law that Congress passed." Durbin Comment Letter at 3. However, Senator Durbin was prescient when he pointed out in his Comment Letter that "the card companies and the $13 trillion dollar banking industry have engaged in near-hysterical criticism of the interchange reform that Congress enacted" and warned that "[a]s we move toward the issuance of final rules, there is no doubt the Board will face a sustained advocacy barrage from financial industry lobbyists." *Id.* This was indeed the case, and Senator Durbin was disappointed that the Board's final rulemaking did not heed Senator Durbin's counsel that "[i]t is imperative that interchange reform be based on the facts and the law, not on the lobbying might and scare tactics of the financial industry." *Id.* at 4.

II. THE BOARD'S FINAL RULE FAILS TO PROPERLY IMPLEMENT THE NETWORK EXCLUSIVITY PROVISIONS OF SECTION 920(b).

A. The Final Rule Does Not Preclude Network- or Issuer-Imposed Arrangements that Require Exclusivity for Certain Electronic Debit Transactions.

Section 920(b)(1)(A) of the Durbin Amendment provides that the Board "shall prescribe regulations providing that an issuer or payment card network shall not…by contract, requirement, condition, penalty or otherwise, restrict the number of payment card networks on which an electronic debit transaction may be processed" to less than two unaffiliated payment card networks. The Board's Final Rule adopts a proposal requiring at least two unaffiliated payment card networks be enabled on each card, but deems a card to be in compliance with the Rule if it has been enabled with one PIN debit network and another unaffiliated signature debit network. 76 Fed. Reg. at 43,447. As the Board notes in its Final Rule, PIN debit networks "are single-message systems in which authorization and clearing information is carried in a single message," while signature debit networks "are dual message systems, in which authorization information is carried in one message and clearing information is carried in a separate message." *Id.* at 43,395.

The Board's Final Rule falls short of complying with the language and intent of the Durbin Amendment. This is because for many types of electronic debit transactions, the Final Rule does not guarantee that networks and their issuers do not have contracts or requirements in place that restrict the number of networks available for transaction processing to less than two unaffiliated networks. The Board has noted that there are a significant number of transaction types in which "single message" PIN debit is not available as an authentication method, leaving "dual message" signature debit as the only currently available option in the marketplace. For example, the Board notes in its Final Rule that "[i]n the current environment…certain transactions, such as hotel stays or car rentals, where the exact amount of the transaction is not known at the time of authorization, cannot readily be accommodated on PIN-based, single-message systems." 76 Fed. Reg. at 43,395.[28] For such types of transactions, it is not a question of the merchants' preference whether or not to process transactions on a single message PIN debit network; rather, the nature of the transaction is simply incompatible with the current PIN

[28] *See also* 75 Fed. Reg. 82,749 ("the Board understands that PIN debit typically cannot be used for hotel stays or car rentals for which a merchant obtains an authorization for an estimated transaction amount, but the actual transaction amount is not known until later, when the cardholder checks out of the hotel or returns the rental car.").

authorization technology and thus PIN is not a feasible[29] means of authorization on which the transaction "may be processed" under Section 920(b)(1)(A). Currently, signature debit networks have arranged for the exclusive use of their signature networks on debit cards,[30] and the Board's Final Rule permits these signature network exclusivity arrangements to continue unabated. The Final Rule thus fails to ensure that an electronic debit transaction "may be processed" over at least two unaffiliated networks, because for those transactions where single-message PIN is not a feasible option, the Final Rule fails to guarantee that networks do not have contracts or requirements providing for exclusive use of one dual message signature debit network.

The need for the Board's Final Rule to guarantee in every instance the availability of multiple unaffiliated networks on which an electronic debit transaction may be processed is compelled by the plain text of Section 920(b)(1)(A) as well as by Senator Durbin's statements of legislative intent. For example, Senator Durbin stated on the Senate floor that:

> This paragraph is intended to enable <u>each and every</u> electronic debit transaction – no matter whether that transaction is authorized by a signature, PIN or otherwise – to be run over at least two unaffiliated networks, and the Board's regulations should ensure that networks or issuers do not try to evade the intent of this amendment by having cards that may run on only two unaffiliated networks where one of those networks is limited and cannot be used for many types of transactions.

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[29] *See* 75 Fed. Reg. at 82,479 ("Because PIN debit transactions are single-message transactions that combine the authorization and clearing instructions, the Board understands that it is <u>currently not feasible</u> to use PIN debit in circumstances where the final transaction amount differs from the authorized transaction amount.") (emphasis added).

[30] *See, e.g.,*75 Fed. Reg. at 81, 748 ("In many cases, issuers have agreed to make the payment card network, or affiliated networks, the exclusive network(s) associated with the issuer's debit cards…Certain signature debit network rules also prohibit issuers of debit cards carrying the signature network brand from offering other signature debit networks or certain competing PIN debit networks on the same card.").

156 Cong. Rec. S5926 (daily ed. July 15, 2010) (statement of Sen. Richard Durbin) (emphasis added).

While the Board claims that it would be burdensome to require that every debit card be enabled with two signature debit networks, neither the text nor Congress's legislative intent mandated that particular outcome as the only way to achieve the statute's goal. The statute was drafted to prohibit a negative scenario (*i.e.*, network- or issuer-imposed exclusivity arrangements), and was not drafted to affirmatively require what the non-exclusive world must look like. *See* Durbin Comment Letter at 11. As the Plaintiffs' brief indicates, one option available to the Board that would be compliant with the statute's requirements would be for the Board to ensure "multiple routing options for every transaction by barring the dominant networks' anti-competitive rules to allow PIN-only networks to process signature transactions, and vice versa." Pl. Br. at 51. The Board was aware of this option, as it was notified about it during the comment period on the NPRM,[31] but the Board chose not to follow this option and instead selected an approach that violates the statute's requirements. The Board could come into compliance with the language and intent of the Durbin Amendment by preventing networks from prohibiting cross-routing of signature and PIN transactions and by ensuring that each card has

[31] *See, e.g.,* Adam J. Levitin Comment Letter, at 2-3 (Feb. 22, 2011), http://www.federalreserve.gov/SECRS/2011/March/20110303/R-1404/R-1404_022211_67815_571419872995_1.pdf ("I would suggest that the Board also be explicit in permitting PIN debit networks to process signature-debit transactions as long as the merchant and/or network is willing to assume the chargeback risk . . . Restricting limitations on cross-routing on debit cards between PIN and signature debit networks would enhance the competition among networks for processing transactions, which is precisely the goal of the Durbin Interchange Amendment."). PIN and signature networks are easily capable of cross-routing; *see, e.g.,* Adam J. Levitin, *Cross-Routing: PIN and Signature Debit Interchangeability Under the Durbin Amendment*, 2 Lydian J. 16 (Dec. 2010), which is referenced in the Levitin comment letter.

multiple unaffiliated dual message network options on which every type of debit transaction may be feasibly processed.[32]

B. The Board Failed to Accurately Convey Senator Durbin's Views of Section 920(b).

The Board states that the Plaintiffs' argument in support of a Final Rule requiring multiple unaffiliated networks for each method of authentication "ultimately depends on a floor statement given by Senator Durbin in which he appears to suggest the Board should issue a rule providing merchants with multiple routing options regardless of the method of authentication." Def. Br. at 52. The Board then attempts to represent Senator Durbin's perspective, arguing that "even Senator Durbin appears to be unconvinced by his floor statement" by misleadingly summarizing and selectively quoting from Senator Durbin's Comment Letter. *Id*. at 52-53.

As discussed above, the Board's Final Rule fails to sufficiently follow the plain language of the Durbin Amendment by failing to ensure that network exclusivity agreements do not restrict the availability of at least two unaffiliated networks on which a debit transaction may be processed. But the Board also provides an erroneous reading of Senator Durbin's Comment Letter in an effort to bolster its argument. The full excerpt from Senator Durbin's Comment letter makes clear the provision's goal of ending network exclusivity agreements, particularly in the signature debit space:

> The amendment did not write specific authorization methods (e.g., PIN and signature) into statute and then mandate how those authorization methods must be treated in a

[32] It should be noted that PIN debit networks are developing dual message capability. *See* Press Release, *SHAZAM Announces Dual Message PIN Transactions and EMV Card Support* (Aug. 22, 2011), https://public.shazam.net/press_releases.html#dualpin ("The SHAZAM Network today announced the creation of a dual-message PIN product, a first for the EFT industry . . . The product will use a dual-message transaction with separate authorization and settlement messages for PIN-based transactions, a capability previously only available on signature-based transactions."). Also, the Board has been given significant flexibility under the statute to set an effective date for such regulations that would give the industry time to prepare for a rule implementing non-exclusivity for dual message transactions. *See* Durbin Comment Letter at 12.

> non-exclusive world. The concern was that doing so would lock acceptance of those authorization methods into federal law, which would run contrary to the overall amendment's goal of incentivizing the development and use of more efficient and more fraud-proof authorization methods than those currently in use in this country. For example, a key goal of the overall amendment is to incentivize the use of better authorization and authentication technologies than the current signature debit system. Thus, it would not be optimal for EFTA 920(b)(1) to specifically require an overhaul of the debit industry to ensure that every card can be transacted over two signature debit networks if the amendment succeeds in incentivizing new authorization methods that quickly supplant signature debit altogether. On the other hand, it would be even less optimal for the goals of ensuring competition and choice if signature debit managed to survive as a common authorization method and if exclusivity arrangements were allowed to continue to predominate in the signature debit space.
>
> Statutory language is limited in its ability to keep pace with potentially fast-moving technological developments in the debit card system. It is for that reason that EFTA 920(b)(1) confers rulemaking discretion upon the Board on how best to guide us through a non-exclusive world. <u>What the statute makes clear is that network- or issuer-imposed network exclusivity agreements (as well as network- or issuer-imposed routing restrictions that achieve the same effect) are to be prohibited under the regulations that the Board prescribes when those regulations take effect</u>. This is essential to the goals of preserving and enhancing competition and choice in the debit system.

Durbin Comment Letter at 12-13 (emphasis added). In sum, the Board's Final Rule provisions on network exclusivity should be revised to comply with the plain language and legislative intent of 920(b)(1)(A)'s guarantee for the availability of at least two unaffiliated networks on which an electronic debit transaction may be processed.

CONCLUSION

The Court should declare that the Final Rule is not in accordance with the Durbin Amendment, and should direct the Board to revise its Final Rule to conform with the plain text and purpose of the Durbin Amendment, as discussed above.

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Respectfully Submitted,

___/s/ David A. Balto____________

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