A STEP IN THE RIGHT DIRECTION: REGULATION OF DEBIT CARD INTERCHANGE FEES IN THE DURBIN AMENDMENT

by
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The Durbin Amendment, a last-minute addition to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, has sparked intense controversy. The Amendment gives the Federal Reserve Board the power to set interchange fees related to debit card transaction processing. Interchange fees, largely unknown to most consumers, are fees that are charged by banks that issue debit cards to consumers and are paid by merchants each time a debit card is swiped in connection with a purchase. The regulations, as well as the Durbin Amendment in general, are hotly contested by networks and banks that claim that they will not be able to recoup their costs, much less make a profit, under the rules. Merchants, however, praise the new regulations and tout the transparency and accountability that the Amendment and the new regulations will bring to the debit card industry. This Comment provides an overview of the Durbin Amendment and the Federal Reserve Board's implementing regulations, and argues that the Amendment and regulations are constitutional and are an appropriate legislative response to a system of debit interchange fees that has spiraled out of control over the past twenty years.

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I. INTRODUCTION

Shortly before Congress passed and the President signed into law the massive Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank or the Act) in the summer of 2010, Senator Richard Durbin of Illinois introduced legislation to be included in the Act that required the Federal Reserve Board (the Board) to implement a comprehensive system of debit card interchange fee regulation in the United States. Interchange fees, largely unknown to most consumers, are fees that are charged by banks that issue debit cards to consumers and are paid by merchants each time a debit card is swiped in connection with a purchase. Interchange fees for debit transactions represent on average 1.14%, or $0.44, of each debit transaction, and in 2009, these fees cost U.S. merchants a staggering $16.2 billion.[1] Despite the importance of such legislation to the banking industry and to merchants in general, Congress did not hold any committee hearings on the legislation nor did it solicit any feedback on it at any point in the two-and-a-half months between the legislation's introduction and its eventual passage as part of Dodd-Frank. However, the new regulations, as well as interchange fees in general, are extremely controversial aspects of debit card systems and raise a number of complex issues.

[1] Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81722, 81725 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

The legislation introduced by Senator Durbin, known informally as the Durbin Amendment (or Amendment), amended the Electronic Fund Transfer Act (EFTA)[2] by adding a new section regarding debit card interchange transaction fees.[3] The amended EFTA directs the Board to issue regulations regarding debit card interchange fees that are reasonable and proportional to the processing costs incurred in a given transaction.[4] The Board is to consider those costs that are part of "the authorization, clearance or settlement" of a particular transaction, but is prohibited from taking into account other costs incurred that are not specific to a particular electronic debit transaction.[5] The Board is also directed to issue regulations regarding costs for fraud prevention as well as rules related to the routing of debit transactions.[6] In issuing proposed regulations in December 2010, the Board offered two alternative sets of rules, both of which proposed to place caps on interchange fees at $0.12 per transaction, a substantial reduction from the estimated average of $0.44 per transaction.[7] The Board's final regulations, which became effective on October 1, 2011, capped interchange fees at $0.21.[8] The regulations, as well as the Durbin Amendment in general, are hotly contested by networks and banks who claim that they will not be able to recoup their costs, much less make a profit, under the rules. Merchants, however, praise the new regulations and tout the transparency and accountability that the Amendment and the new regulations will bring to the debit card industry.

This Comment examines the Durbin Amendment within the context of economic, historic, and policy considerations of the debit card and related industries, and evaluates the proposed and final rules promulgated by the Board and the legal challenges and criticisms put forth by networks and banks in response. The Comment argues that, in contradiction to the contentions made by the networks and banks, the Durbin Amendment and the Board's regulations are a lawful and appropriate legislative response to a system of debit interchange fees that has spiraled out of control over the past 20 years. Specifically, this Comment argues that 1) the Durbin Amendment and the Board's

[2] 15 U.S.C. §§ 1693–1693r (2006).

[3] The Durbin Amendment applies only to financial institutions, including their affiliates, with assets over $10 billion, and does not apply to credit cards. Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068–74 (2010).

[4] *Id.* at 2068.

[5] *Id.* at 2068–69.

[6] *Id.* at 2069–70.

[7] Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81726.

[8] Press Release, Bd. of Govs. of the Fed. Res. Sys., Federal Reserve Issues a Final Rule Establishing Standards for Debit Card Interchange Fees and Prohibiting Network Exclusivity Arrangements and Routing Restrictions (June 29, 2011), *available at* http://www.federalreserve.gov/newsevents/press/bcreg/20110629a.htm.

regulations are constitutional and do not deprive issuers of the ability to recoup costs in violation of the Takings, Due Process, or Equal Protection Clauses; 2) the Board's regulations will be given deference under *Chevron* standards; and 3) policy considerations support an approach to interchange fee regulation that utilizes a neutral third party to set appropriate regulations over the previous approach of network-set fees. Although the effects of the Amendment have yet to be seen or extensively studied, and additional research should be conducted, the Durbin Amendment has the potential to fulfill its stated purpose of "holding big banks accountable for how they operate and empowering consumers to make good financial choices."[9]

Part II of the Comment begins with a basic primer on the debit card system and the fees associated with a particular debit transaction. Part III provides a historical and economic background for examining debit card systems. Next, in Part IV, the Comment provides an overview of the Durbin Amendment and the Board's proposed and final regulations for implementing it. With this in mind, Part V of the Comment then proceeds to analyze the constitutionality of the Durbin Amendment under the Takings, Due Process, and Equal Protection Clauses. Part VI discusses why the Board's regulations will likely be given deference under *Chevron*. And finally, the Comment concludes by offering thoughts about the benefits of using a neutral third party such as the Board to implement interchange fee regulations.

II. BASIC FEATURES OF THE DEBIT CARD INDUSTRY

Debit and credit card usage in the United States increased more than 5,000% in just over a decade from the early 1990s to 2002.[10] In 2009, debit card purchases accounted for 37.9 billion transactions and represented 35% of all noncash payment transactions.[11] Over this same time period, the use of both checks and cash as payment methods correspondingly declined.[12] Debit cards allow individuals electronic access to their bank accounts,[13] and thus are typically issued to customers that have a checking account with a particular financial institution.[14]

[9] 156 CONG. REC. S4839 (daily ed. June 10, 2010) (statement of Sen. Durbin).

[10] DAVID E. EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING, 205–06 (2d ed. 2005).

[11] Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81723.

[12] *Id.*

[13] "Demand deposit account" or "DDA" as used in the banking industry. Lloyd Constantine et al., *Repairing the Failed Debit Card Market: Lessons From an Historically Interventionist Federal Reserve and the Recent* Visa Check/MasterMoney Antitrust Litigation, 2 N.Y.U. J.L. & BUS. 147, 157–58 (2005) [hereinafter Constantine et al., *Repairing the Failed Debit Card Market*].

[14] *See* Robin A. Prager et al., *Interchange Fees and Payment Card Networks: Economics, Industry Developments, and Policy Issues* 10 (Div. of Research & Statistics & Monetary Affairs, Fed. Res. Bd., Working Paper No. 23, 2009), *available at*

Debit cards contain many features similar to checks, although unlike debit cards, checks clear at-par.[15] At-par clearance means that there is no loss to the merchant except for a fee that the merchant pays its bank to process the transaction.[16] When first introduced, some forms of debit card transactions similarly cleared at-par or even with negative interchange.[17] Over the years, however, this system changed dramatically and today all forms of debit cards have significant interchange fees associated with their usage.[18]

There are two primary debit systems operational in the United States: signature-based debit and PIN-based debit.[19] Both are processed electronically, but each use distinct processing and verification schemes to effectuate debit transactions.[20] Signature debit transactions route through the networks (i.e., Visa and MasterCard) in two steps—authorization followed by settlement, and cardholders either sign for purchases, or when the transaction is not completed in person, provide some other type of verification.[21] PIN transactions require verification through the use of a unique personal identifier and are processed over an electronic funds transfer (EFT) network and cannot take place unless a merchant has installed a PIN-pad device; consequently, PIN debit is not available for certain types of purchases such as online purchases.[22] The

http://www.federalreserve.gov/pubs/feds/2009/200923/200923pap.pdf; EVANS & SCHMALENSEE, *supra* note 10, at 207.

[15] *See* Constantine et al., *Repairing the Failed Debit Card Market*, *supra* note 13, at 156–57, 180, 188–89. Banks are required to use Federal Reserve Facilities in order to take advantage of at-par clearance, and today virtually all banks participate in this system. *Id.* at 156–57.

[16] *Id.* at 156. The concept of at-par clearance is likely familiar to most consumers. For example, "[i]f consumer A makes a check payable to consumer B for $50, B can take it to A's bank and cash it for exactly $50. A's bank cannot charge B a fee for cashing the check, although it may charge its own customer, A, according to the contractual terms of A's checking account plan. If B instead has its own bank collect the check from A, B's bank can charge B for the service it provides to B, but B's bank receives $50 from A's bank." Alan S. Frankel & Allan L. Shampine, *The Economic Effects of Interchange Fees*, 73 ANTITRUST L.J. 627, 638 (2006). Except for fees directly negotiated with their own banks, merchants are thus able to receive the full face value of checks when used as payment by consumers, assuming they route through the Federal Reserve System.

[17] Constantine et al., *Repairing the Failed Debit Card Market*, *supra* note 13, at 160, 165. Negative interchange meant that per-transaction payments were made to merchants to create incentives for the merchant to install PIN pads and therefore increase the usage of PIN debit generally. *Id.* at 160.

[18] *See generally id.*

[19] EVANS & SCHMALENSEE, *supra* note 10, at 11. PIN refers to "personal identification number." *Id.* at 7.

[20] Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81722, 81723–24 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

[21] *Id.* at 81723.

[22] *Id.* at 81723–24. In addition, because PIN debit is authorized and settled in one routing, it does not work for certain transactions that often cannot be completed

authorization and settlement of funds for PIN debit takes place in one step.[23] Because customers are required to enter a PIN, and because authorization and settlement occur simultaneously, PIN debit transactions are typically considered much more secure and have historically cost less to process.[24]

In the United States, there are two distinct electronic payment systems that operate to process all debit and credit card transactions—the so-called three-party and four-party systems.[25] The lesser-used three-party system is the model employed by financial institutions such as American Express and Discover for their credit card programs.[26] The three parties involved in the transaction are the network (i.e., American Express or Discover), the merchant, and the consumer.[27] In this model, both merchants and consumers contract directly with the network for card use.[28] Rather than the networks setting the fees, the card issuer determines the fees in connection with each merchant.[29] Typically the three-party system is not used for debit card transactions.[30]

The more common system, and the system used to process most debit card transactions, is the four-party system.[31] The four-party system is a slight misnomer because it actually includes five parties: the consumer, the bank that issues the card to the consumer (the card issuer), the merchant, the merchant's bank (the merchant acquirer), and the network (the fifth party—i.e., Visa or MasterCard).[32] In this system, the network does not issue cards directly to consumers but instead contracts with banks, credit unions, and other financial institutions to issue cards.[33] Further, the networks unilaterally set the fees associated with four-party systems with no negotiation by merchants. In the four-party system, a debit transaction takes place as follows: when a consumer goes to make a purchase by presenting his or her debit card to the merchant, the merchant/merchant acquirer routes an electronic authorization request

in a simultaneous routing because the exact amount of the transaction is not known when the card is swiped, such as hotel stays and car rentals. *Id.*

[23] *Id.*

[24] Constantine et al., *Repairing the Failed Debit Card Market*, *supra* note 13, at 158–59.

[25] Prager et al, *supra* note 14, at 9. Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81723.

[26] Prager et al, *supra* note 14, at 9–10.

[27] *Id.* at 10.

[28] *Id.* at 10, 26.

[29] *Id.* at 12–13, 25–26.

[30] *Id.* at 9–10.

[31] *Id.* This Comment focuses exclusively on the four-party system.

[32] *Id.* at 10.

[33] *Id.* In order to take part in the network, issuers must agree to specific operating rules issued by the networks that govern the relationships between various network participants. For example, the rules cover such things as card acceptance practices and other technological specifications for processing transactions. Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81724.

using the transaction amount to the network, which transfers the request to the card issuer.[34] The card issuer then checks its files and sends either an authorization or decline message to the merchant based on whether, for example, sufficient funds are present in the customer's account.[35] Depending on the type of debit card used (signature- or PIN-based debit), at some point after the authorization, the card issuer posts a charge to the customer's account for the transaction's full face value, and the merchant acquirer posts a credit to the merchant's account, less certain fees associated with processing the transaction.[36]

The fees associated with each transaction typically include the interchange fee, the merchant discount, and the switch fee.[37] The merchant discount, paid by the merchant to the merchant acquirer, represents the bulk of all fees and consists of the difference between the face value of the transaction and amount transferred to the merchant.[38] Using the funds collected as part of the merchant discount, the merchant acquirer pays interchange fees and switch fees.[39] Interchange fees are set by the relevant network and are typically the largest portion of the fees paid on any given transaction.[40] Both the merchant acquirer and the card issuer are entitled to interchange fees, with the card issuer receiving a higher percentage of the interchange fee.[41] In addition, both the merchant acquirer and the card issuer also pay the network switch fees to compensate the network for its role in processing the transaction, again in amounts usually less than the interchange fee. To the consumer, these fees are essentially hidden,[42] and, in fact, merchants are forbidden under their contractual obligations with the networks from imposing a surcharge on consumers to use debit payment systems (or other payment systems, like credit cards, that are similarly operated by the networks).

As previously mentioned, interchange fees are set at the network level, and there is no negotiation between any affected party—such as card issuers, merchant acquirers, or merchants—and the network.[43] The

[34] Prager et al, *supra* note 14, at 10–11.

[35] *Id.*

[36] *Id.* With PIN debit, the card issuer posts a charge immediately upon authorization on the cardholder's account. For signature debit, the charge is normally posted within about one day of the transaction. *Id.* at 11.

[37] Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81723–24.

[38] *Id.* at 81724.

[39] *Id.* at 81723–24.

[40] *Id.* at 81724.

[41] *Id.* at 81723–24.

[42] *Id.* As discussed below in Part III, the fact that the fees are paid by merchants and not consumers directly reflects the operation of the debit industry as part of a two-sided market. By directing the bulk of the costs to one side of the market, the other side (the consumers) are supposed to be enticed into taking part in the market, thus making the market more advantageous for all players as a whole. EVANS & SCHMALENSEE, *supra* note 10, at 129.

[43] Prager et al., *supra* note 14, at 12–14.

fee schedule set by the networks is complex and can vary depending on a number of factors, including the type of electronic payment card used (i.e., credit, PIN debit, or signature debit); the type of merchant involved (e.g., clothing store, grocery store, electronics store); the type of card (e.g., premium versus standard cards); and the merchant's sales volume.[44] The structure of the fee also varies and may comprise either a flat fee, a percentage of the purchase price, or some combination of the two.[45] Average interchange rates in 2009 for PIN debit were $0.35 to $0.50 per transaction; for signature debit transactions, 1.2% of the transaction value; and for credit card transactions, 1.5 to 2% of the transaction value.[46] Contractual obligations with the networks do not permit card issuers to alter the interchange rates that they charge to merchants.[47]

III. HISTORICAL AND ECONOMIC PERSPECTIVES ON THE DEBIT CARD INDUSTRY

A. Brief History of the Development, and Subsequent Elimination of, At-Par Debit Clearance

Visa and MasterCard, which collectively control nearly 80% of the payment card market,[48] were integral in developing the current debit and credit systems that are operational in the United States today. The 1960s and 70s marked the origins of both PIN and signature debit in the United States.[49] Signature debit arose as a result of efforts by Visa and MasterCard and represented an expansion of their existing credit card programs.[50] Signature debit utilized the same infrastructure that was already in place to process credit card transactions, but instead of making a purchase on credit, the debit functionality allowed a customer a direct line to his or her bank account.[51] The infrastructure for PIN debit, on the other hand, was not controlled by Visa and MasterCard and had been built instead through a distinct network of operators over automated teller machine (ATM) networks.[52] Modern ATM capabilities were first

[44] *Id.* at 25.

[45] *Id.* at 12.

[46] *Id.*

[47] *Id.* at 12–13.

[48] Adam J. Levitin, *Payment Wars: The Merchant-Bank Struggle for Control of Payment Systems*, 12 STAN. J. L. BUS. & FIN. 425, 430 (2007).

[49] Fumiko Hayashi et al., *A Guide to the Debit and ATM Card Industry* 19–20 (Fed. Res. Bank of Kan. City, Working Paper No. 02-03, Apr. 7, 2003), *available at* http://info.worldbank.org/etools/docs/library/83934/Hayashi_April2003.pdf.

[50] Constantine et al., *Repairing the Failed Debit Card Market*, *supra* note 13, at 160.

[51] *Id.*

[52] *Id. See also* EVANS & SCHMALENSEE, *supra* note 10, at 206–10. This infrastructure was developed for ATM transactions and routed through electronic funds transfer networks that are distinct from the systems that process signature-based debit transactions. *Id.* As differentiated from a debit transaction where a purchase is made for a good or service, an ATM transaction involves withdrawing cash from an ATM

introduced in the late 1960s and the use of such systems expanded rapidly due to high demand.[53] Dual cards began to issue that allowed customers direct access to funds in their accounts through ATMs as well as through direct purchases at participating merchants.[54] The debit functionality of dual cards was just a logical next step—the cards were already linked to customers' accounts, and the process of connecting the networks for PIN debit developed with relative ease.[55] These developments, along with PIN debit's "superiority in safety, speed and cost, initially made PIN debit the preferred debit product for banks."[56]

Initially, interchange fees for signature debit mirrored that of Visa and MasterCard's credit card interchange fees, whereas the PIN debit model developed with either at-par clearance or with negative interchange.[57] Interchange fees were not necessary to the PIN debit model because the infrastructure had been developed and financial institutions had already distributed over 130 million ATM debit cards by the time PIN debit was on the rise.[58] Throughout the 1980s and 90s, both forms of debit continued to be used, although not nearly at the volume they are used today.[59] PIN debit transactions accounted for approximately 60% of debit transactions by the 1990s, and "[were] poised to grow even faster" in the years ahead.[60]

The growing popularity of PIN debit that operated on distinct ATM networks was of particular concern to Visa and MasterCard, and fearing a reduction in their respective market shares, the networks undertook a number of steps in the 1990s to infuse themselves into the PIN debit card market and to increase usage of their signature debit products.[61] For example, Visa launched an aggressive marketing campaign in the 1990s to introduce its "New Shape of Checking."[62] The "campaign told

machine using a card that is often a dual purpose ATM/debit card, verified through a personal identification number. Hayashi et al., *supra* note 49, at 6–7.

[53] Hayashi et al., *supra* note 49, at 19–21.

[54] *Id.* at 7.

[55] Constantine et al., *Repairing the Failed Debit Card Market*, *supra* note 13, at160.

[56] *Id.*

[57] *Id.*

[58] *Id.* at 161.

[59] *Id.*; Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81722, 81723 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

[60] Constantine et al., *Repairing the Failed Debit Card Market*, *supra* note 13, at 161.

[61] EVANS & SCHMALENSEE, *supra* note 10, at 206–08.

[62] *Id.* Visa and MasterCard operated throughout this time in fierce competition with one another as well. As part of Visa's campaign promoting its signature debit products as against PIN debit carriers in general, one of its main targets was MasterCard. Visa wanted to differentiate itself from MasterCard, and it was successful in so doing: before its advertising campaign began, "when consumers were asked which card was accepted at more merchants, 35 percent [of consumers that responded] said Visa and 28 percent said MasterCard. [After the campaign], almost three times as many consumers said Visa as said MasterCard" despite the cards being accepted at nearly the same number of merchants. *Id.* at 199–200.

consumers that they could use Visa Check cards anywhere Visa cards were accepted and in the same way as any other Visa card."[63] Also in the 1990s, Visa acquired Interlink (the largest debit network that processed more than 60% of all PIN debit) and MasterCard made a similar acquisition.[64] Within months, the networks changed the fee structures—Visa shifted PIN debit from at-par clearance to a positive interchange rate equal to $0.45 on a $100 purchase.[65]

At this time, Visa and MasterCard each instituted an Honor All Cards (HAC) rule that forced merchants that accepted Visa (or MasterCard) credit cards to also accept Visa (or MasterCard) signature debit cards, regardless of the terms under which they were offered.[66] Because merchants had little choice but to accept Visa and MasterCard credit cards to remain competitive in the market, they were forced to accept the networks' signature debit products as well, often at supracompetitive prices similar to the interchange fees for credit cards.[67] Like today, PIN debit was much safer and more secure, and was therefore the preferred product for merchants.[68] Card issuers, realizing the potential value of signature debit over PIN debit, began pushing signature debit aggressively and tried to suppress PIN usage.[69] Other anticompetitive tactics were also employed to sway customers from using PIN debit, such as anti-steering acts, in which Visa and MasterCard issued rules that prevented merchants from encouraging or promoting PIN debit in any way over signature debit.[70] As discussed further below, these tying arrangements and anti-steering practices were eliminated in 2004 after merchants brought a successful antitrust action against Visa and MasterCard that resulted in one of the largest antitrust settlements to date.

In *In re Visa Check/MasterMoney Antitrust Litigation*, a group of merchants brought suit against Visa and MasterCard challenging the HAC arrangements and other alleged deceptive and anticompetitive practices.[71] Plaintiffs presented evidence that showed that without the tying rules, these networks would not have been able to charge such high

63 *Id.* at 207.

64 Constantine et al., *Repairing the Failed Debit Card Market*, *supra* note 13, at 164.

65 *Id.*

66 *Id.* at 166.

67 Lloyd Constantine et al., In re Visa Check/MasterMoney Antitrust Litigation*: A Study of Market Failure in a Two-Sided Market*, 2005 COLUM. BUS. L. REV. 599, 606 (2005) [hereinafter Constantine et al., *A Study of Market Failure*].

68 *Id.*

69 *Id.* at 610. Higher interchange fees would result in higher profits with little to no corresponding increase in usage costs for the products for card issuers.

70 Constantine et al., *Repairing the Failed Debit Card Market*, *supra* note 13, at 168. MasterCard's rule was explicit: "Merchants may not engage in acceptance practices or procedures that discriminate against, or discourage the use of, MasterCard cards in favor of any other card brand . . . ." *Id.* (internal citation omitted).

71 297 F. Supp. 2d 503, 506-07 (E.D.N.Y. 2003).

interchange fees for their signature debit card products, and also that the development of PIN debit products in the United States was severely manipulated by the practices employed to decrease the use of PIN debit.[72] While Visa and MasterCard were forced to pay merchants more than $3 billion in a settlement against them,[73] the results of this and similar antitrust suits have, in practice, been mixed at best. Although the HAC rules and similar anticompetitive tactics were eliminated,[74] interchange fees have not necessarily decreased. In fact, on the day that the settlement required Visa and MasterCard to reduce debit interchange fees, they each actually raised credit fees, and it is speculated that merchants have been paying out more in interchange fees in general since that settlement.[75]

B. *A Primer on Economic Principles Related to the Debit Card Industry*

From an economic perspective, the debate over interchange fees presents a number of interesting and complex questions. One principal factor underlying these concerns is how well interchange fees help to produce an efficient payment card market (in economic terms, how well the system balances the needs of all of the parties in order to advance the needs of *each* party to the greatest extent possible).[76] Thus, with "an appropriately chosen interchange fee, a payment card will be used in a transaction whenever doing so yields a higher level of overall social welfare than would be obtained by using an alternative payment method. With such an interchange fee, the number of card transactions will be economically efficient."[77] To achieve economic efficiency in payment systems, however, is an extremely complex task.

Debit cards operate in a two-sided market, which is a type of market that exists when a product's value is realized only when two seemingly distinct customers both agree to use the product.[78] For example, in the newspaper business, the newspaper sells the paper's news and advertising content to readers, and advertisers of other products purchase ad space because of such readership.[79] Readers and advertisers operate dependently on one another in order for the newspaper to be successful. Similarly, with debit card systems, the same interdependent demand is present with regard to consumers and merchants: consumers will not carry particular cards if merchants do not accept them, and merchants

[72] *Id.* at 507, 515–16. *See also* Constantine et al., *A Study of Market Failure*, *supra* note 67, at 607–08.

[73] *In re Visa Check*, 297 F. Supp. 2d at 508.

[74] Constantine et al., *Repairing the Failed Debit Card Market*, *supra* note 13, at 176–77.

[75] K. Craig Wildfang & Ryan W. Marth, *The Persistence of Antitrust Controversy and Litigation in Credit Card Networks*, 73 ANTITRUST L.J. 675, 690 (2006).

[76] Prager et al., *supra* note 14, at 3, 14–15.

[77] *Id.* at 3.

[78] *Id.* at 14–15.

[79] Constantine et al., *A Study of Market Failure*, *supra* note 67, at 601.

will not accept cards if not enough consumers carry them.[80] Two-sided markets raise special pricing issues that are not typically present in regular supply-and-demand markets because pricing schemes must be balanced at appropriate levels in order to ensure that both sides will participate.[81] One solution often employed by firms competing in such markets to solve this chicken-and-egg problem is to set prices so that one side carries a significantly higher burden, meaning that their costs are much higher, thereby inducing the other side to participate at much lower costs (e.g., the typical practice of setting newspaper subscription prices below actual costs in order to gain readership and thus advertisers).[82]

In *In re Visa Check*, discussed above, Visa and MasterCard unsuccessfully claimed that merchants could not prove antitrust injury because of the presence of a two-sided market. Because a two-sided market might solve its balancing problems by skewing payments toward one side, Visa and MasterCard claimed that the tying arrangements they undertook requiring merchants to accept their signature debit products simply acted to solve the chicken-and-egg problem and allowed them to introduce signature debit successfully to an existing base of merchants who already accepted their credit cards.[83] Thus, the tying arrangements were enacted to overcome the two-sided nature of the market and were not anticompetitive. These arguments failed, however, because the tying arrangements not only resulted in supracompetitive pricing that drove debit acceptance by merchants massively downward, but also because issuers no longer wanted to issue debit cards to consumers because they gained increased revenue by issuing signature debit products that garnered higher interchange fees.[84] The result was that both sides of the vastly superior debit product's two-sided market were affected by the tying arrangements.

Network-set interchange fees certainly have the ability to produce economically efficient interchange fees that respond to the demands in two-sided markets. However, because typical supply-and-demand principles are absent in two-sided markets, networks lack the proper incentives to balance the needs of parties on each side of the market. Thus, while there is no magic formula for setting economically efficient interchange fees that appropriately balance demands, the two-sided nature of the debit card market increases the likelihood that networks will be able to adopt anticompetitive price fixing in debit markets.

[80] Prager et al., *supra* note 14, at 15.

[81] Constantine et al., *A Study of Market Failure*, *supra* note 67, at 602–03.

[82] *Id.* at 602–03, 605.

[83] *Id.* at 610–11.

[84] *Id.* at 610–15.

IV. OVERVIEW OF THE DURBIN AMENDMENT AND THE BOARD'S PROPOSED AND FINAL REGULATIONS FOR IMPLEMENTING IT

A. *Legislative History*

Congress passed the Durbin Amendment without holding any committee hearings and without offering a formal opportunity for affected persons or institutions to express their views on the Amendment to Congress. However, several statements made by the Amendment's sponsor, Senator Durbin, are reflected in the Congressional Record.[85] In those statements, Senator Durbin expressed that his intended purpose in proposing the Amendment was "to give small businesses and merchants and their customers across America a real chance in the fight against the outrageously high swipe fees charged by Visa and MasterCard."[86] Further, the Amendment sought "to prevent the big banks from basically rigging the financial system in a way that helps Wall Street and hurts the shops on Main Street" because "[t]his current system is not sustainable. If left alone, it is going to get worse for small businesses that face higher fees, for consumers who face higher prices, and for everyone but the banks and credit card networks."[87] Other than these statements, however, the record is devoid of any legislative history surrounding the passage of the Amendment.

B. *The Board's Regulations*

In furtherance of the Durbin Amendment's purported objectives as described by Senator Durbin, the Amendment directs the Board to implement a comprehensive system of debit card interchange fee regulation in the United States.[88] In September 2010, before issuing any proposed rules, the Board solicited feedback on the Durbin Amendment by distributing surveys to card issuers, networks, and merchant acquirers.[89] Based on survey responses and the Board's independent analysis of the Durbin Amendment, in December 2010, the Board issued proposed regulations.[90] The Board issued final regulations on June 29, 2011, which became effective October 1, 2011.[91]

[85] 156 CONG. REC. S4977 (daily ed. June 16, 2010) (statement of Sen. Durbin); 156 CONG. REC. S4839 (daily ed. June 10, 2010) (statement of Sen. Durbin).

[86] 156 CONG. REC. S4839.

[87] 156 CONG. REC. S3695–96 (daily ed. May 13, 2010) (statement of Sen. Durbin).

[88] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068–74 (2010).

[89] Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81722, 81724–25 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

[90] *Id.* at 81724.

[91] Press Release, Bd. of Govs. of the Fed. Res. Sys., *supra* note 8.

1. Reasonable and Proportional Fees

The Durbin Amendment directs the Board to promulgate standards for interchange rates that are reasonable and proportional to the costs incurred in processing debit transactions. Section 920(a)(2) of the amended EFTA provides: "Reasonable Interchange Transaction Fees.—The 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."[92]

In issuing regulations, the Board was required to consider a number of factors. These include the "functional similarity" between debit systems and check systems that are required to clear at-par through the Federal Reserve Bank as well as the "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."[93] The Board may not, however, consider "other costs incurred by an issuer which are not specific to a particular electronic debit transaction."[94]

In the Board's initial draft of the regulations, it proposed and sought comment on two different structures of the fee systems: one with a safe harbor and a cap on fees, and one with a straight cap on fees.[95] Under the first option, a card issuer could either take advantage of a $0.07 safe harbor without calculating its allowable costs, or it could calculate its allowable costs in accordance with the rules of the statute, so long as it did not go above a $0.12 cap.[96] A card issuer's allowable costs would be those costs attributable to its role in the authorization, clearance, or settlement of a particular electronic debit transaction, which would be totaled over a 12-month period and divided by the number of transactions processed in that year.[97] This rate, of course, could not exceed the $0.12 cap.[98] Under the second option, the safe harbor and allowable costs calculation would be eliminated, and card issuers would only need to ensure that they set interchange fees below the maximum $0.12 cap.[99]

The Board's final regulations represent a modified version of the second option. The rule provides that an issuer may not receive or charge an interchange transaction fee in excess of $0.21.[100] According to

[92] Dodd-Frank Wall Street Reform and Consumer Protection Act § 1075, 124 Stat. at 2068 (emphasis added).

[93] *Id.* at 2068–69.

[94] *Id.* at 2069.

[95] Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81726.

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *Id.*

[100] Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43394, 43422 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235).

the Board, the $0.21 "corresponds to the per-transaction allowable cost . . . of the issuer at the 80th percentile, based on data collected by the Board in a survey of covered issuers."[101]

2. Fraud Prevention Costs

The Amendment allowed the Board to take into account preventing fraud in its regulations.[102] Specifically, the Board was permitted to adjust the fee received or charged by a card issuer in order "to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit card transactions involving that issuer."[103] Issuers were also required to "take effective steps to reduce the occurrence of, and costs from, fraud in relation to electronic debit transactions, including through the development and implementation of cost-effective fraud-prevention technology."[104]

Initially, the Board issued two proposed rules to comply with these requirements. The first concentrated on major innovations that could be implemented across the board to prevent fraud on an industry-wide scale, while the second looked at reasonable steps that an issuer might take to prevent fraud on a more individualized scale.[105] The final rule includes two avenues for issuers to recoup costs related to fraud prevention. First, in addition to the flat $0.21 per transaction interchange fee, issuers are permitted to add five basis points of the transaction's value.[106] The basis points correspond to the average per-transaction fraud losses of the median issuer, according to the Board.[107] Second, the rules allow

> for an upward adjustment of no more than 1 cent to an issuer's debit card interchange fee if the issuer develops and implements policies and procedures reasonably designed to achieve the fraud-prevention standards set out in the interim final rule. If an issuer meets these standards and wishes to receive the adjustment, it must certify its eligibility to receive the adjustment to the payment card networks in which it participates.[108]

3. Exclusivity Arrangements

The Board was also required to issue regulations to prohibit issuers or networks from "restricting . . . the number of payment card networks on which an electronic debit transaction may be processed to fewer than two unaffiliated payment card networks."[109] This means that networks may not dictate the network over which card issuers and merchant

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[101] *Id.*
[102] Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81740.
[103] *Id.*
[104] *Id.*
[105] *Id.* at 81740, 81742.
[106] Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43422.
[107] *Id.*
[108] Press Release, Bd. of Govs. of the Fed. Res. Sys., *supra* note 8.
[109] Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81748.

acquirers route transactions and instead must allow for competition among routing networks. However, rather than requiring that there be the option of two PIN- and two signature-based networks, the final rule only requires that issuers do not restrict the number of payment card networks to one PIN-based network and one signature-based debit network. Under the rule, it is sufficient for an issuer to issue a debit card that can be processed over one signature-based network and one PIN-based network, provided the networks are not affiliated.[110]

4. Scope

The Durbin Amendment's scope is limited to banks, credit unions, and other depository institutions (including their affiliates) that issue debit cards and have assets of $10 billion or greater.[111] Because of this, out of the approximately 8,000–9,000 banking institutions operating in the United States, only 80–90 banks, or approximately one percent, of the total banks will be subject to these regulations.[112] Further exempted are debit cards or prepaid cards issued by the government pursuant to a federal, state, or local government-administered payment program.[113] The $10 billion exemption does not apply to the exclusivity provisions discussed above, meaning that all institutions that issue debit cards must follow those restrictions.[114]

V. THE DURBIN AMENDMENT OUGHT TO WITHSTAND CONSTITUTIONAL SCRUTINY

A. *Takings and Due Process Clause Challenges*

Perhaps the strongest critique brought by opponents of the Durbin Amendment is that the law violates the Takings and Due Process Clauses of the Fifth Amendment by depriving issuers of the ability to collect a reasonable rate of return, as well as a reasonable profit, on their debit card programs.[115] In a lawsuit filed shortly after Dodd-Frank was signed into law, TCF National Bank, a depository institution and issuer of debit cards, challenged the constitutionality of the Durbin Amendment on the grounds that the Amendment would deprive it of more than $80 million in debit card interchange fee revenue, revenue that it says is necessary to operate its programs and that cannot be recouped elsewhere.[116] TCF will

[110] Press Release, Bd. of Govs. of the Fed. Res. Sys., *supra* note 8.
[111] Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81722.
[112] 156 CONG. REC. S4977 (daily ed. June 16, 2010) (statement of Sen. Durbin).
[113] Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81726.
[114] *Id.*
[115] *See, e.g.*, Brief for The Clearing House Ass'n et al. as Amici Curiae Supporting Petitioners at 3, 8, TCF National Bank v. Bernanke, 643 F.3d 1158 (8th Cir. 2011) (No. 11-1805); Amended Complaint at 28, 47, 49–50, TCF National Bank v. Bernanke, No. 4:10-cv-04149-LLP (D.S.D. Jan. 27, 2011).
[116] Amended Complaint, *supra* note 115, at 38, 40, 49–50.

be subject to the Durbin Amendment as a debit card issuer with more than $10 billion in assets.[117] TCF sought a preliminary injunction to enjoin enforcement of the Durbin Amendment.[118] The Eighth Circuit upheld the district court's denial of the preliminary injunction, finding TCF unlikely to prevail on the merits.[119]

TCF asserted that its business is sustained in large part through its free checking account program that currently has over 1.5 million accounts in existence.[120] As part of its "long-standing strategy of providing low-cost, convenient banking services," TCF provides its checking account customers a number of benefits including free debit cards and free online banking and bill pay.[121] Last year, TCF earned just over $100 million from debit card interchange fees that support these programs.[122] Without the ability to collect fees in the range it now collects, TCF alleged that it would suffer revenue losses of nearly 80%, allegedly leaving it unable to recoup its costs in providing debit services and without any ability to profit from its programs.[123] Specifically, TCF argued that it would not be able to recover anything but a "tiny fraction" of its costs and would no longer be able to recover the "expenses of establishing a debit program, marketing/advertising the program, placing cards in the hands of customers, handling complaints or questions from customers, providing consumer benefits and many other costs of servicing this payment system."[124] Further, the fraud adjustment provisions included in the Durbin Amendment would not provide significant relief, as TCF projected that it would only result in an additional $3 million in recovery, because according to TCF, that is all its fraud prevention programs cost.[125] The Eighth Circuit did not reach the question of whether or not a sufficient property interest was present with regard to interchange fees, finding instead that the Durbin Amendment was likely to withstand rational basis review. If it had reached the question, TCF's arguments would have failed because it would have been unable to show a cognizable property interest or a sufficient economic impact necessary for a takings violation.

The Takings Clause provides that "private property [shall not] be taken for public use, without just compensation,"[126] and the Due Process Clause provides that "no person shall be . . . deprived of . . . property,

[117] *Id.* at 9.
[118] TCF Nat'l Bank v. Bernanke, 643 F.3d 1158, 1162 (8th Cir. 2011).
[119] *Id.* at 1165.
[120] Amended Complaint, *supra* note 115, at 8.
[121] *Id.* at 8–9.
[122] *Id.* at 40.
[123] *Id.* at 40–41.
[124] *Id.* at 38–39.
[125] *Id.* at 40–41.
[126] U.S. CONST. amend. V.

without due process of law."[127] The two clauses operate somewhat in tandem, with the Takings Clause focusing on protection of the underlying substantive property right, and the Due Process Clause looking at the merits and validity of the governmental action.[128] The substantive protections apply to physical takings of private property for public use as well as to regulatory takings, where rather than the government taking title or possession of the property at issue, the government instead regulates the owner's use of the property.[129] Therefore, with regulatory takings, the government is "defin[ing] or limit[ing] how far certain property may be used and enjoyed by its owner."[130] With regulatory takings, "[t]he general rule [is] that while property may be regulated to a certain extent, if a regulation goes *too far* it will be recognized as a taking."[131] In evaluating regulatory takings, "[t]he greatest weight is given to the judgment of the legislature."[132]

1. Regulatory Takings First Require a Sufficient Property Interest

A threshold requirement in any Takings or Due Process claim is the showing of a protected, cognizable property interest.[133] What constitutes a sufficient property interest is a controversial issue that is not well settled.[134] Property interests are not created by the Constitution, but

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[127] *Id.*

[128] Despite distinct constitutional language, the Takings and Due Process Clauses are analyzed similarly and "[t]he Supreme Court has . . . developed a regulatory takings doctrine that effectively merges the Due Process and Takings Clauses." Roderick E. Walston, *The Constitution and Property: Due Process, Regulatory Takings, and Judicial Takings*, 2001 UTAH L. REV. 379, 379 (2001).

[129] *See* Michael B. Rappaport, *Originalism and Regulatory Takings: Why the Fifth Amendment May Not Protect Against Regulatory Takings, but the Fourteenth Amendment May*, 45 SAN DIEGO L. REV. 729, 732 (2008); *see also* Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211, 223 (1986) ("In the course of regulating commercial and other human affairs, Congress routinely creates burdens for some that directly benefit others. For example, Congress may set minimum wages, control prices, or create causes of action that did not previously exist. Given the propriety of the governmental power to regulate, it cannot be said that the Taking Clause is violated whenever legislation requires one person to use his or her assets for the benefit of another.").

[130] William P. Barr et al., *The Gild That Is Killing the Lily: How Confusion over Regulatory Takings Doctrine Is Undermining the Core Protections of the Takings Clause*, 73 GEO. WASH. L. REV 429, 436 (2005).

[131] Pa. Coal Co. v. Mahon, 260 U.S. 393, 415 (1922) (emphasis added).

[132] *Id.* at 413.

[133] *See* Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1000 (1984) (looking first to the existence of "a property interest protected by the Fifth Amendment's Taking Clause"); Wyatt v. United States, 271 F.3d 1090, 1097 (Fed. Cir. 2001) (a "bedrock requirement" for a Takings Clause challenge is "the existence of a valid property interest"); Hospice of N.M., L.L.C. v. Sebelius, 691 F. Supp. 2d 1275, 1293 (D.N.M. 2010) ("The threshold question in a Takings Clause claim is whether Plaintiff has identified a cognizable property interest.").

[134] *See, e.g.*, Bd. of Regents of State Colls. v. Roth, 408 U.S. 564, 571–72 (1972); Hawkeye Commodity Promotions, Inc. v. Vilsack, 486 F.3d 430, 439–40, (8th Cir. 2007).

"[r]ather . . . are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law—rules or understandings that secure certain benefits and that support claims of entitlement to those benefits."[135] A property interest therefore must be more than an "abstract need or desire" or "a unilateral expectation" of a single party.[136] There must be a "legitimate claim of entitlement" to the property that people "rely [on] in their daily lives."[137]

In *Hawkeye Commodity Promotions, Inc. v. Vilsack*, plaintiff, an owner of video lottery machines, brought an action against state officials alleging that state legislation ending the lottery game for which the video machines were used was a violation of, *inter alia*, the Takings Clause.[138] Hawkeye claimed a violated property interest in the lottery video machines, in its contracts for services, its business, and in the continued operation of its enterprise.[139] The court acknowledged that limited property rights existed with respect to parts of Hawkeye's claims, but the claims together were insufficient for a Takings Clause challenge.[140]

As to the existence of property rights, the court held that there was sufficient property interest in the machines and at least some property interest in the business itself.[141] However, Hawkeye did not have a sufficient property interest in the continuation of its business or in its contracts for services.[142] The court looked at the fact that Hawkeye's participation in the lottery game system required a state-issued license, which the court concluded was only a privilege and not a right enjoyed by Hawkeye, and thus it could have no property right in the continuation of its business.[143] Likewise, as to its contracts claims, because the contracts allowed for termination due to a change in law or regulation, no sufficient property interest existed.[144]

2. *The* Penn Central *Factors*

In addition to requiring a sufficient property interest, courts also analyze a number of other factors in regulatory takings cases. In 1978, the Supreme Court decided *Penn Central Transportation Co. v. New York City*,[145] a seminal case on the issue of regulatory takings. New York City had prohibited construction of an office building above a railroad terminal because the terminal was considered an historic landmark.[146] The

135 *Bd. of Regents of State Colls.*, 408 U.S. at 577.
136 *Id.*
137 *Id.*
138 486 F.3d 430, 435 (8th Cir. 2007).
139 *Id.* at 439–40.
140 *Id.* at 442.
141 *Id.* at 439–40.
142 *Id.* at 440.
143 *Id.* at 439–40.
144 *Id.* at 440.
145 438 U.S. 104 (1978).
146 *Id.* at 115–18.

landowner challenged the prohibition as violative of the Takings Clause.[147] The Court, admitting that it heretofore had been unable to develop any set formula for regulatory taking violations, stated that the appropriate inquiry is one that "depends largely 'upon the particular circumstances [in that] case.'"[148] The Court announced the following test for regulatory takings:

> In engaging in these essentially ad hoc, factual inquiries, the Court's decisions have identified several factors that have particular significance. The economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations are, of course, relevant considerations. So, too, is the character of the governmental action. A "taking" may more readily be found when the interference with property can be characterized as a physical invasion by government, than when interference arises from some public program adjusting the benefits and burdens of economic life to promote the common good.[149]

Later courts have distilled the *Penn Central* test down to three prongs: 1) "[t]he economic impact of the regulation on the claimant"; 2) "the extent to which the regulation has interfered with distinct investment-backed expectations"; and 3) the "character of the governmental action."[150]

For example, the *Hawkeye* court evaluated Hawkeye's Takings Clause challenge under the *Penn Central* factors. The court acknowledged that under the first prong, the economic impact was devastating to Hawkeye's business—the business as it stood was necessarily wiped out.[151] However, when balanced with the other *Penn Central* factors, the financial impact was not enough to constitute a taking.[152] Under the second prong, several factors undermined Hawkeye's expectations as to its business, including "the heavily regulated nature of gambling in [the state]"; the existence of contractual language that allowed for termination or change based on new laws or regulations; and the owner's personal experience with similar industries.[153] While Hawkeye no doubt "hoped that the Legislature would not stringently regulate or abolish [the particular lottery game]," such expectation could constitute nothing more than a "unilateral expectation or . . . abstract need."[154] As to the third prong, the

[147] *Id.* at 119.

[148] *Id.* at 124 (quoting United States v. Central Euerka Mining Co., 357 U.S. 155, 168 (1958)).

[149] *Id.* (internal citations omitted).

[150] Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 538–39 (2005) (quoting *Penn Central*, 438 U.S. at 124).

[151] Hawkeye Commodity Promotions, Inc. v. Vilsack, 486 F.3d 430, 442 (8th Cir. 2007).

[152] *Id.*

[153] *Id.*

[154] *Id.* (citation and internal quotation marks omitted).

government regulation merely prevented one specific use of the machines—one that the court considered to be "a single stick in the bundle of property rights."[155] Therefore, no Takings Clause violation existed.

B. Under Regulatory Takings Standards, the Durbin Amendment and the Board's Regulations Are Not Takings

1. There Are Not Sufficient Property Interests in Interchange Fees

Hawkeye demonstrates that there is at least *some* protected property interest in a business itself.[156] The Supreme Court agreed—"[t]he assets of a business (including its good will) unquestionably are property, and any state taking of those assets is unquestionably a 'deprivation.'"[157] However, the interest at stake in this context is not necessarily the *business interest* itself, but instead is an interest in the collection of future interchange fees. This type of property interest has not historically been recognized: "business in the sense of *the activity of doing business,* or *the activity of making a profit* is not property in the ordinary sense."[158] Like in *Hawkeye*, the interests at stake here will not likely be recognized as a protected property interest because financial institutions lack any independent right to collect such fees. Additionally, they have no property interests whatsoever in collection of the fees because the fees are dependent on factors outside the control of the card issuers.

No independent state or federal statute or regulation entitles financial institutions to collect interchange fees. Furthermore, private contractual rights fail to establish an inherent right to collect. In *Hawkeye*, private contractual rights were subject to termination due to changes in state law, and it was well known that gambling was a heavily regulated industry in the state.[159] The court therefore found it highly likely that the law might change and effectively nullify plaintiff's private contractual interests. This meant that Hawkeye's contracts were not considered cognizable property interests for Takings Clause purposes.[160] Likewise, card issuers enter into contractual relationships with networks in order to be able to issue their debit cards, but those contracts leave the interchange fees solely in the hands of the networks. Visa's operating principles confirm: "In the event of any conflict between the Visa Operating Regulations and any applicable laws or regulations, the

[155] *Id.* (citation and internal quotation marks omitted).

[156] *Id.* at 439.

[157] Coll. Sav. Bank v. Fla. Prepaid Postsecondary Educ. Expense Bd., 527 U.S. 666, 675 (1999).

[158] *Id.*

[159] *Hawkeye Commodity Promotions, Inc.*, 486 F.3d at 440.

[160] *Id.*

requirements of such law or regulation will govern."[161] As discussed in more detail below, card issuers retain no negotiating power in the interchange fees they charge. Further, the banking industry is heavily regulated and even financial institutions themselves acknowledge the inherent risk given the network's role in setting interchange fees.[162]

Because Visa and MasterCard unilaterally set interchange fees without negotiating with any other party, any expectation of future interchange fees rests solely at the discretion of Visa and MasterCard. No actual competition exists over the interchange fees—issuers simply take what is given to them by the networks, and as a result the fees do not actually reflect the costs of processing the transaction.[163] Visa's operating principles again clarify:

> Interchange is consistently monitored and adjusted—sometimes increased and sometimes decreased—in order to ensure that the economics present a competitive value proposition for all parties. . . . Visa may establish different interchange reimbursement fees in order to promote a variety of system objectives, such as enhancing the value proposition for Visa products, providing incentives to grow merchant acceptance and usage, and reinforcing strong system security and transaction authorization practices.[164]

Therefore, because the fees are dependent on factors outside the control of card issuers, issuers lack any cognizable property interests in collection of such fees.

2. *Issuers Do Not Meet the* Penn Central *Factors*

Assuming *arguendo* that a cognizable property interest is found, it is still necessary to show that the government regulation has gone too far to find a violation under the Takings Clause.[165] Using *Penn Central*'s three-prong test, it will be difficult to show that the Durbin Amendment reaches this level. Under the economic impact prong of *Penn Central*, there is little doubt that the financial impact of the Durbin Amendment on financial institutions as a whole is enormous—issuers are projected to collect 80% less in fees than the previous year, amounting to a reduction in earnings of nearly $12 billion a year.[166] As the Comptroller of the Currency notes, while "[t]he impact . . . has not been studied, . . . it is

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[161] *Visa International Operating Regulations Core Principles*, VISA USA, 4 (April 1, 2010), http://usa.visa.com/download/merchants/visa-international-operating-regulations-core.pdf.

[162] In a recent disclosure statement to the Securities and Exchange Commission, Visa readily admitted that "[i]nterchange fees are subject to significant legal and regulatory scrutiny worldwide, which may have a material adverse impact on our revenues, our prospects for future growth and our overall business." *Visa, Inc. Form S-1 Registration Statement*, U.S. SEC. & EXCH. COMM'N (Nov. 9, 2007), *available at* http://www.sec.gov/Archives/edgar/data/1403161/000119312507242653/ds1.htm.

[163] 156 CONG. REC. S10996 (daily ed. Dec. 22, 2010) (statement of Sen. Durbin).

[164] *Visa International Operating Regulations Core Principles*, *supra* note 161, at 10.

[165] Pa. Coal Co. v. Mahon, 260 U.S. 393, 415 (1922).

[166] Brief for the Clearing House Ass'n et al., *supra* note 115, at 8, 11.

clear that it will change how financial institutions, both large and small, will do business."[167] In the case of TCF, it alone projects its interchange fee revenues to drop nearly 80 percent.[168] Many other financial institutions are in a similar position and have either instituted or are planning to institute significant changes to their debit card operations as a result of the Durbin Amendment.[169] Consequently, the financial industry unanimously opposes the Amendment.[170] Although the size and proportionality of the economic loss are generally not decisive, "the greater the economic impact of a government action the greater the likelihood of a taking."[171] The Supreme Court, however, has recently emphasized that not only must there be an economic impact, but the impact must be severe enough that it is "functionally equivalent to the classic taking in which government directly appropriates private property."[172]

Several factors, however, undermine the severity of the economic impact at issue here. First, courts do not necessarily measure financial impact in terms of particular percentages, and even severe reductions in revenues are not necessarily considered takings.[173] Courts undertake a variety of strategies to evaluate the economic impact.[174] Here the impact

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[167] Letter from Comptroller of the Currency, Admin'r of Nat'l Banks, to Jennifer J. Johnson, Sec'y, Bd. of Govs. of the Fed. Res. Sys. (Mar. 4, 2011), *available at* http://www.fsround.org/fsr/dodd_frank/pdfs/OCCInterchangeCommentLetter3.4.11.pdf.

[168] Amended Complaint, *supra* note 115, at 40.

[169] *See, e.g.*, David Benoit, *U.S. Bancorp Plans New Checking Pricing; Profit Jumps*, WALL ST. J. (January 19, 2011, 3:46 PM), http://online.wsj.com/article/SB10001424052748704590704576091631996905022.html (announcing U.S. Bancorp's plan to introduce new pricing on checking accounts and remove rewards in anticipation of the Durbin Amendment's proposed changes); Ann Carrns, *Chase to End Debit Card Rewards*, N.Y. TIMES BUCKS BLOG (March 21, 2011, 5:07 PM), http://bucks.blogs.nytimes.com/2011/03/21/chase-to-end-debit-card-rewards/ (discussing JPMorgan Chase's mailing of letters to customers announcing that it will stop offering debit card rewards in response to the Durbin Amendment).

[170] *See* Letter from The Am. Bankers Ass'n et al., to Jennifer J. Johnson, Sec'y, Bd. of Govs. of the Fed. Res. Sys. (February 22, 2011), *available at* http://www.theclearinghouse.org/index.html?f=072358 (major banks and banking-institution trade unions expressed near-unanimous support for the repeal of the Durbin Amendment).

[171] John D. Echeverria, *Making Sense of* Penn Central, 23 UCLA J. ENVTL. L. & POL'Y 171, 178 (2005).

[172] Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 539 (2005).

[173] *See, e.g.*, Agins v. City of Tiburon, 447 U.S. 255, 262 (1980); Hawkeye Commodity Promotions, Inc. v. Vilsack, 486 F.3d 430, 442 (8th Cir. 2007).

[174] *See* Echeverria, *supra* note 171, at 180–83. For example, various approaches that have been used to measure economic impact include 1) measuring the economic impact by comparing, at the date of the supposed taking, the fair market value of the property as subject to the challenged regulation and as *not* subject to the regulation; 2) comparing the value of the property as currently regulated and the owner's original cost; or 3) considering the impact of the regulation on the profitability of a particular investment. *Id.*

can be considered highly speculative: it is potentially limited not only by the exclusivity provisions contained in the Durbin Amendment restraining networks' ability to impose certain restrictions on merchants who accept payment cards, but by changing, unknown market conditions, as well.[175] Specifically, by increasing the number of payment card networks on which transactions may run, the Amendment will likely increase competition over networks and presumably drive down processing costs. Therefore, market conditions and other provisions of the Durbin Amendment call into question the projected financial impact of the Durbin Amendment on financial institutions.

Additionally, and as discussed above, interchange fees are set at the network level and the financial institutions that issue debit cards generally have no negotiating power as to the fees.[176] The networks have the ability to set fees at their discretion, and card issuers have little choice but to accept the fees. Therefore, the financial impact is speculative at best. As one commentator has noted, under any test a court might apply, "if property retains some economic value in the marketplace, a takings claim will likely fail, or at least the economic impact factor will not help the claimant."[177]

Under the second *Penn Central* prong, which looks at the "extent to which the regulation has interfered with distinct investment-backed expectations,"[178] there must be a demonstrable, reasonable interest that constitutes "more than a unilateral expectation or an abstract need."[179] In *Golden Pacific Bancorp v. United States*,[180] the Court of Appeals for the Federal Circuit examined this element within the context of the banking industry. Because of the "highly regulated nature of the banking industry . . . [plaintiff] could not have had a historically rooted expectation of compensation."[181] The court examined the specific characteristics of the banking industry that differentiated it from other scenarios, such as regulatory takings of proprietary trade interests by forcing disclosure of trade secrets, concluding that the choice to invest in a bank was categorically different because the bank was a member of a "highly regulated industry" and thus there could be no reasonable expectations.[182]

[175] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2072 (2010).

[176] *See supra* Part II.

[177] Echeverria, *supra* note 171, at 183.

[178] Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 539 (2005).

[179] Ruckelshaus v. Monsanto Co., 467 U.S. 986, 1005 (1984) (quoting Webb's Fabulous Pharmacies, Inc. v. Beckwith, 449 U.S. 155, 161 (1980)).

[180] 15 F.3d 1066 (Fed. Cir. 1994).

[181] *Id.* at 1074.

[182] *Id.* at 1074–75.

The third prong of *Penn Central* examines the character of the government regulation.[183] There are varying interpretations of what this factor means,[184] but in *Hawkeye*, the Eighth Circuit considered both the fact that video lottery machines had other uses and that the business still had value in its trade routes and goodwill, which could be put to use in any other business.[185] Similarly, in this case the government regulation only affects one specific fee charged by covered financial institutions and in no way affects the entirety of the business of any of these massive institutions. In addition, the regulations do not eliminate the ability to charge fees, but rather limit the fees to only processing costs.

C. *Confiscatory Rate-Setting Jurisprudence as an Alternative Theory*

Opponents of the Durbin Amendment contend that rather than the traditional Takings Clause analysis, the proper constitutional inquiry rests on confiscatory rate-setting jurisprudence which considers rates to be confiscatory when they do not allow a reasonable rate of return for investors.[186] In *TCF*, the Eighth Circuit found that because the Durbin Amendment only restricts processing costs, but does not restrict how much issuers can directly charge their customers for debit card services, it was unclear whether a price control had been (or indeed ever could be) created so as to trigger confiscatory rate analysis.[187] Even assuming plaintiff could establish a price control, arguments related to confiscatory price controls are traditionally applied within the context of public utility companies, where a natural monopoly is granted to a utility, but where the government retains limited financial control over the utility.[188] Because the government retains this control over the utility, some basic protections are granted to utilities to ensure a reasonable rate of return for investors.[189] Price controls of public utilities will only be invalid if they are "arbitrary, discriminatory, or demonstrably irrelevant" to the policy that the legislature is attempting to adopt.[190] Opponents of the Durbin Amendment argue that the confiscatory line of cases properly applies to private companies (such as the networks and card issuers), and that under such a line of inquiry, the Amendment and proposed regulations constitute confiscatory rates.[191] However, these arguments are likely to fail

[183] Lingle v. Chevron U.S.A. Inc., 544 U.S. 528, 539 (2005).

[184] *See generally* Echeverria, *supra* note 171, at 186–208.

[185] *See* Hawkeye Commodity Promotions, Inc. v. Vilsack, 486 F.3d 430, 442 (8th Cir. 2007).

[186] *See* Amended Complaint, *supra* note 115, at 28–29; Brief for the Clearing House Ass'n et al., *supra* note 115, at 3.

[187] TCF Nat'l Bank v. Bernanke, 643 F.3d 1158, 1164 (8th Cir. 2011).

[188] Barr et al., *supra* note 130, at 431.

[189] *Id.*

[190] Nebbia v. New York, 291 U.S. 502, 539 (1934).

[191] Amended Complaint, *supra* note 115, at 47–49; Brief for the Clearing House Ass'n et al., *supra* note 115, at 11.

because networks and issuers lack the defining traits of public utilities and thus will not be subject to rate-setting jurisprudence.

A public utility is characterized as a business that has been granted a monopoly by the government and is required to engage in the continued provision of goods or services for the benefit of the public.[192] The utility provides goods or services that are "so essential to communal and economic life" that government necessarily shares responsibility in ensuring their adequate supply at reasonable rates.[193] Typically things such as the supply of water, power, communications, and transport fall into this category.[194] Certain characteristics are typical of public utilities: 1) a specific requirement by law that the company engage in a specific output; 2) a restriction on exiting a part or all of the specific business output; and 3) the government maintains "ultimate control over the economic opportunity associated with the enterprise."[195]

For example, in *Minnesota Association of Health Care Facilities, Inc. v. Minnesota Department of Public Welfare*, the Eighth Circuit addressed the extension of the confiscatory doctrine and held that utility rate-setting jurisprudence has no application to nonpublic utilities.[196] Specifically, plaintiffs in the case, owners and operators of nursing home facilities, challenged a Minnesota statute that, as a condition to participating in the state's Medicaid program, limited rates that nursing homes could charge to those residences not receiving state medical assistance benefits.[197] The court held that the public utility cases were not applicable because the nursing home had the "freedom to decide whether to remain in business and thus subject themselves voluntarily to the limits imposed by Minnesota on the return they obtain[ed] from investment of their assets in nursing home operation."[198] Furthermore, participation in the state Medicaid program was also voluntary.[199] Even if the "reimbursement rates [were] insufficient," the facilities had the option of "mak[ing] their homes more efficient and economical or terminat[ing] their relationship with Medicaid and no longer accept[ing] Medicaid recipients as residents."[200]

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[192] Barr et al., *supra* note 130, at 431.

[193] *Id.* at 439.

[194] *Id.*

[195] *Id.* at 440–41.

[196] 742 F.2d 442, 446 (8th Cir. 1984). *But cf.* Calfarm Ins. Co. v. Deukmejian, 771 P.2d 1247 (Cal. 1989) (extending, without discussion, rate-setting jurisprudence to insurance carriers in California where a voter-passed initiative required, *inter alia*, reduction of insurance rates to 20% below the previous year's rates).

[197] *Minn. Ass'n of Health Care Facilities, Inc.*, 742 F.2d at 444.

[198] *Id.* at 446.

[199] *Id.*

[200] *Id.* Similarly, in *Garelick v. Sullivan*, plaintiffs, a group of anesthesiologists, alleged that a federal statute designed to control Medicare costs constituted a taking because it compelled physicians to provide services to Medicare patients (and thus to submit to the price regulations), and also because the statute "ameliorate[d] the

Networks and card issuers are not similar to public utilities and thus the Durbin Amendment and the Board's proposed regulations should not be subject to confiscatory rate-setting jurisprudence. The fact that the government subjects a business to price regulation in some form is not dispositive. First, networks and card issuers do not meet the defining characteristics of a public utility because they voluntarily entered into the banking industry and thus do not have any of the typical compulsory characteristics that exist with regard to classic utility regimes. Whereas a public utility serves as a "substitute for the state in the performance of [a] public service . . . thus becoming a public servant,"[201] there is no corresponding duty contemplated by those involved in the banking industry or, more specifically, in the debit card business. In addition, because the compulsory nature of the regulated entity is lacking, private businesses are not entitled to the same level of protection under rate-setting jurisprudence. Public utility investors are given heightened protection due to the risk involved in recovering their investment because of the compulsory aspects of the utility. The utility further lacks complete discretion insofar as various other business and economic opportunities are concerned because of the requirement to produce certain outputs. Investors in financial institutions that supply debit cards do not share these characteristics as the institutions are free to engage in their services as they see fit, subject to the laws of the jurisdictions in which they operate. Thus, such financial institutions do not meet the required criteria to be considered public utilities and will be unable to benefit from confiscatory rate-setting jurisprudence.[202]

D. *The Durbin Amendment Does Not Violate the Equal Protection Clause*

TCF also challenged the Durbin Amendment as violating the Equal Protection Clause, claiming that it arbitrarily and unfairly discriminates against financial institutions with assets of $10 billion or greater.[203] Under

burden of increasing medical costs upon elderly and disabled Medicare beneficiaries by decreasing compensation to physicians." 987 F.2d 913, 915–16 (2d Cir. 1993). The court rejected these claims, finding that because the plaintiffs were not "legally compelled to engage in price-regulated activity," the regulations did not give rise to a taking. *Id.* at 916.

[201] Barr et al., *supra* note 130, at 442 (quoting Missouri *ex rel.* Sw. Bell Tel. Co. v. Pub. Serv. Comm'n of Mo., 262 U.S. 276, 291 (1923) (Brandeis, J., dissenting)).

[202] Since the rate-setting cases are not applicable, the typical standard for reviewing economic regulations is under substantive due process, and so long as the regulations have "a reasonable relation to a proper legislative purpose" and are not arbitrary or discriminatory, the regulations will not be the subject of judicial scrutiny. *Minn. Ass'n of Health Care Facilities, Inc.*, 742 F.2d at 447. The Durbin Amendment meets this standard because the regulations at issue, as described above, are seeking to level the playing field in providing more fair rates and preventing merchants from having to bear the entire costs of operating a debit card program. Thus, the Amendment has a rational relationship to the end sought and is neither arbitrary nor discriminatory and thus will easily survive substantive due process scrutiny.

[203] Amended Complaint, *supra* note 115, at 50–51.

the Equal Protection Clause, when a law regulates ordinary economic activity, it is subject only to a rational basis scrutiny, the lowest level of scrutiny.[204] Under rational basis review, deference is given to the governmental regulation—practically any conceivable basis for the classification will be upheld.[205] It is up to the challenger of the regulation to negate "every conceivable basis which might support [the regulation]." Because a legislature is not required to "articulate its reasons for enacting a statute, it is entirely irrelevant for constitutional purposes whether the conceived reason for the challenged distinction actually motivated the legislature."[206]

In this case, the exemption for institutions with assets of less than $10 billion is justified through Congress's purported desire to safeguard smaller financial institutions' revenue-generating ability as against larger financial institutions. As Senator Durbin noted,

> This duopoly, this power in the market, this ability to terrorize credit unions and small banks is an indication of too much power and too little competition. If we truly believe in a free market and an entrepreneurial society, we have to support competition. In this case, merchants, businessmen, small banks, and small credit unions are being terrorized by these powerful interests.[207]

Thus, the exemption was designed to ensure fairness among market participants and to allow these smaller institutions to operate competitively in the market and to issue debit cards to consumers. These justifications are further buttressed by the fact that the $10 billion exemption does not apply to the network exclusivity provisions, and thus *all* financial institutions that operate debit card programs must work to operate competitively in the market.

VI. THE BOARD'S REGULATIONS WILL BE GIVEN DEFERENCE UNDER *CHEVRON*

The Durbin Amendment does not create any specific regulations, but instead directs the Board to "prescribe regulations . . . to *establish standards for assessing* whether the amount of any interchange transaction fee described . . . is *reasonable and proportional* to the cost incurred by the issuer with respect to the transaction."[208] The Board put forth two proposals in furtherance of this objective, both of which include setting caps on allowable interchange fees.[209] The cap on fees is one of the most controversial aspects of the Board's proposal, with some arguing that the

[204] *See* FCC v. Beach Commc'ns, Inc., 508 U.S. 307, 313–15 (1993).
[205] *Id.* at 314–15.
[206] *Id.* at 315.
[207] 156 CONG. REC. S4977 (daily ed. June 16, 2010) (statement of Sen. Durbin).
[208] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068 (2010) (emphasis added).
[209] *See supra* Part IV.B.1.

caps were outside Congress's grant of authority to the Board.[210] Despite these allegations, courts should give deference to the interpretation of the Board under *Chevron* standards.[211]

Under *Chevron*, statutory interpretations by government agencies are normally entitled to deference, unless the agency's construction is clearly contrary to the intent of Congress, or if an otherwise acceptable construction raises serious constitutional concerns.[212] Neither of these factors is present in this case. In proposing to set specific caps under each proposed plan, the Board reasoned that it would disincentivize issuers from engaging in debit card programs with substantially higher per-transaction costs and instead encourage issuers to reduce costs. It declined to include cost recoveries for any costs other than those related to the authorization, clearance, and settlement of a transaction, those costs specifically addressed by the statute. Specifically, it disallowed costs such as network fees, cardholder rewards programs, and costs in providing service to customers on the cards. By excluding these costs the Board believed it would remain most true to its legislative mandate. The cap, despite "significantly reduc[ing] interchange fees from current levels[,] . . . allows for the recovery of per-transaction variable costs for a large majority of covered issuers."[213] The Board based this decision on data from a survey of card issuers.[214] Therefore, under *Chevron*, the Board's regulations are clearly not contrary to its grant of congressional authority, and for the reasons set forth above, the regulations also do not raise any serious constitutional concerns. Thus, the regulations should be entitled to deference under *Chevron* standards.

VII. CONCLUSION

The Durbin Amendment represents a bold and unprecedented approach to regulating debit card interchange fees in the United States. For the first time ever, interchange fees—a more than $16 billion industry—will be out of the hands of the free market and within the control of a neutral arbiter, the Federal Reserve Board. The Board's regulations seek to effectuate a massive overhaul that has the potential to reduce revenues by no longer allowing card issuers to take account of costs other than those directly related to the authorization, settlement, and clearance of a debit transaction. Yet the Durbin Amendment and the

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210 Letter from The Fin. Servs. Roundtable to Jennifer J. Johnson, Sec'y, Bd. of Govs. of the Fed. Res. Sys. 6 (February 22, 2011), *available at* http://www.fsround.org/fsr/policy_issues/regulatory/pdfs/pdfs11/FINAL-RoundtableInterchangeCommentLetter2.22.11.pdf.

211 *See* Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984).

212 Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council, 485 U.S. 568, 574–75 (1988) (citing *Chevron*, 467 U.S. at 842–43 & n.9 (1984)).

213 Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81722, 81737 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

214 *Id.*

Board's regulations offer a promising reform to a system that has spiraled out of control over the past twenty years. The benefits of using debit cards are high for consumers, merchants, financial institutions, and the networks. Each party benefits in a number of ways, which explains why debit cards are growing so quickly in popularity. The Durbin Amendment is not poised to change that. Networks should not be allowed to foist the entire cost of operating a debit card program onto merchants alone, and collusive price-setting regimes should be rejected. The Durbin Amendment and the Board's regulations present a lawful approach to stopping such behavior.