Oral Argument Scheduled January 17, 2014

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 13-5270

NACS, FORMERLY KNOWN AS NATIONAL ASSOCIATION OF CONVENIENCE STORES, ET AL.,

Plaintiffs-Appellees,

vs.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Defendant-Appellant.

On Appeal from the United States District Court
For the District of Columbia,
Case No. 1:11-cv-02075-RJL
Judge Richard J. Leon

BRIEF OF APPELLEES

Shannen W. Coffin
Douglas S. Kantor
Linda C. Bailey
STEPTOE & JOHNSON LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 429-3000
scoffin@steptoe.com
dkantor@steptoe.com
lbailey@steptoe.com
Attorneys for Plaintiffs-Appellees

November 20, 2013

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to Circuit Rule 28(a)(1), the undersigned counsel of record certifies as follows.

A. Parties, Intervenors, and Amici

The following is a list of all parties, intervenors, and amici in this case and the case below:

Parties

- NACS (formerly National Association of Convenience Stores), plaintiff-appellee
- National Retail Federation, plaintiff-appellee
- Food Marketing Institute, plaintiff-appellee
- Miller Oil Co., Inc., plaintiff-appellee
- Boscov's Department Store, LLC, plaintiff-appellee
- National Restaurant Association, plaintiff-appellee
- Board of Governors of the Federal Reserve System, defendant-appellant ("the Board" or "the Fed")

Amici below

- Clearing House Association, LLC
- American Bankers Association
- Consumer Bankers Association
- Credit Union National Association
- Financial Services Roundtable
- Independent Community Bankers of America

- Mid-Size Bank Coalition of America
- National Association of Federal Credit Unions
- National Bankers Association
- Senator Richard J. Durbin
- 7-Eleven, Inc.
- Auntie Anne's, Inc.
- Burger King Corporation
- CKE Restaurants, Inc.
- International Dairy Queen, Inc.
- Jack in the Box, Inc.
- Starbucks Corporation
- Wendy's Company

B. Rulings Under Review

The following ruling by The Honorable Richard J. Leon of the United States District Court for the District of Columbia is under review: the Memorandum Opinion and Accompanying Order filed on July 31, 2013, which granted Plaintiffs' Motion for Summary Judgment. The decision is available at 2013 WL 3943489 (D.D.C. Jul. 31, 2013), Civ. No. 11-2075 (RJL). The District Court decision invalidated portions of the Board's Final Rule, Debit Card and Interchange Fees and Routing, 76 Fed. Reg. 43,394 (July 20, 2011).

C. Related Cases

This case has not previously been before this Court. At this time, to the knowledge of undersigned counsel there are no related cases within the meaning of Circuit Rule 28(a)(1)(C).

/s/ Shannen W. Coffin
Shannen W. Coffin

CORPORATE DISCLOSURE STATEMENTS

A. NACS

NACS (formerly the National Association of Convenience Stores) is a trade association representing more than 2,100 retail and 1,600 supplier company members, mostly in the United States, but also abroad. NACS, Inc. has no parent companies, subsidiaries, or affiliates, and is privately held.

B. National Retail Federation

The National Retail Federation ("NRF") is the world's largest retail trade association. It represents retailers of all types and channels of distribution, including department, specialty, discount, catalog, Internet, independent stores, chain restaurants, drug stores and grocery stores, from the United States and more than 45 countries abroad. The NRF and its subsidiary, NRF Enterprises, are privately held.

C. Food Marketing Institute

The Food Marketing Institute ("FMI") advocates on behalf of the food retail industry. FMI's U.S. members operate nearly 40,000 retail food stores and 25,000 pharmacies, with a combined annual sales volume of almost $770 billion. Through programs in public affairs, food safety, research, education and industry relations, FMI offers resources and provides valuable benefits to more than 1,225 food retail and wholesale member companies in the United States and around the world. FMI membership covers the spectrum of diverse venues where food is sold, including single owner grocery stores, large multi-store supermarket chains, and mixed retail

stores. FMI does not have any parent companies, subsidiaries, or affiliates requiring disclosure.

D. National Restaurant Association

The National Restaurant Association ("NRA"), represents the restaurant and foodservice industry, which contains over 980,000 locations and roughly 13.1 million employees. NRA is the leading national association representing this industry, and its members account for over one-third of the industry's retail locations. NRA is a non-profit corporation, with no parent companies, subsidiaries, or affiliates which have outstanding securities in the hands of the public.

E. Miller Oil Co., Inc.

Miller Oil Company, Inc. ("Miller"), headquartered in Norfolk, Virginia, sells residential heating oil, heating and air-conditioning service, commercial fuels, and wholesale fuels, in addition to running convenience store and gasoline retailing business. Miller has no parent companies, subsidiaries, or affiliates, and is privately held.

F. Boscov's Department Store, LLC

Boscov's Department Store, LLC ("Boscov's"), currently has a chain of 43 full-service department stores (with 7,500 employees), reaching across five states in the Mid-Atlantic region of the country, as well as an online store. Boscov's and its parent companies, subsidiaries and affiliates are privately held.

/s/ Shannen W. Coffin
Shannen W. Coffin

TABLE OF CONTENTS

TABLE OF AUTHORITIES viii
GLOSSARY xiii
STATEMENT OF ISSUES PRESENTED 1
PERTINENT STATUTES & REGULATIONS 1
STATEMENT OF THE CASE 2
STATEMENT OF FACTS 5
I. Debit Cards and Debit Card Networks 5
II. The Rise in Debit Card Fees 8
III. The Durbin Amendment 10
A. The Interchange Fee Standard 11
B. Network Fee Regulation 12
IV. The Board's Proposed Rule 13
V. The Final Rule 14
VI. The District Court's Decision 17
SUMMARY OF ARGUMENT 19
ARGUMENT 23
I. Standard of Review 23
II. The Final Rule's Interchange Fee Standard Violates the APA 25
A. The Board's Interpretation of Its Interchange Fee Authority Fails at *Chevron* Step One 25
1. The Durbin Amendment Plainly Limits Allowable Costs to Those Costs Specifically Delineated in 15 U.S.C. § 1693o-2(a)(4)(B)(i) 26
2. Traditional Tools of Statutory Interpretation Foreclose the Board's Interpretation 30
3. The Board's Interpretation of the Excludable Cost Provision Contravenes Its Plain Language 34

4. The Particular Items of Costs Considered by the Board Are Foreclosed from Consideration by the Durbin Amendment 38

B. The Board's Interpretation Is Unreasonable 44

III. The Final Rule's Implementation of the Durbin Amendment's Network Non-Exclusivity Provision Violates the APA 45

A. The Board's Non-Exclusivity Regulation Fails *Chevron*'s First Step 45

1. The Final Rule Contravenes the Plain Language of the Statute...45

2. The Final Rule Permits Networks to Maintain Rules and Practices that Inhibit Merchant Competitive Choice................47

3. The Statute's Legislative History Confirms that Merchants Must Be Given a Choice of Network for Each Transaction.....53

B. The Board's Interpretation Is Unreasonable and Fails *Chevron*'s Second Step 55

CONCLUSION 56

CERTIFICATE OF COMPLIANCE

CERTIFICATE OF FILING AND SERVICE

ADDENDUM OF STATUTES & REGULATIONS

TABLE OF AUTHORITIES[1]

Page(s)

CASES

ABA v. FTC,
430 F.3d 458 (D.C. Cir. 2005) 24, 32

American Petroleum Institute v. EPA,
198 F.3d 275 (D.C. Cir. 2000) 31

American Petroleum Institute v. EPA,
706 F.3d 474 (D.C. Cir. 2013) 27

Associated General Contractors, Inc. v. California State Council of Carpenters,
459 U.S. 519 (1983) 47

Barnhart v. Thomas,
540 U.S. 20 (2003) 30

Barrett v. Van Pelt,
268 U.S. 86 (1925) 29

Begier v. IRS,
496 U.S. 53 (1990) 33

Bell Atlantic Telephone Companies v. FCC,
131 F.3d 1044 (D.C. Cir. 1997) 26

Blair-Bey v. Quick,
151 F.3d 1036 (D.C. Cir. 1998) 33

Brown v. Gardner,
513 U.S. 115 (1994) 31

Cascade Health Solutions v. Peacehealth,
515 F.3d 883 (9th Cir. 2008) 40

[1] Authorities upon which Appellees chiefly rely are marked with asterisks.

Catawba County, N.C. v. EPA,
571 F.3d 20 (D.C. Cir. 2009)..32

**Chevron, U.S.A., Inc. v. Natural Resources Defense Council*,
467 U.S. 837 (1984)..19, 23, 24, 51, 54

City of Cleveland, Ohio v. U.S. Nuclear Regulatory Comm'n,
68 F.3d 1361 (D.C. Cir. 1995)..44

Engine Mfrs. Ass'n v. EPA,
88 F.3d 1075 (D.C. Cir. 1996)..37

Entergy Corp. v. Riverkeeper, Inc.,
556 U.S. 208 (2009)...27, 37, 38

Ethyl Corp. v. EPA,
51 F.3d 1053 (D.C. Cir. 1995)..32

FDA v. Brown & Williamson Tobacco Corp.,
529 U.S. 120 (2000)...23

GTE Serv. Corp. v. FCC,
205 F.3d 416 (D.C. Cir. 2000)..55

Halverson v. Slater,
129 F.3d 180 (D.C. Cir. 1997)..31, 41

Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.,
530 U.S. 1 (2000)...25

Hearth, Patio & Barbecue Ass'n v. U.S. Dep't of Energy,
706 F.3d 499 (D.C. Cir. 2013)..41

In re Visa Check/MasterMoney Antitrust Litigation,
192 F.R.D. 68 (E.D.N.Y. 2000)..9

Japan Whaling Ass'n v. Am. Cetacean Soc'y,
478 U.S. 221 (1986)...32

Kimberlin v. U.S. Dep't of Justice,
318 F.3d 228 (D.C. Cir. 2003)..34

Massachusetts v. U.S. Dep't of Transp.,
93 F.3d 890 (D.C. Cir. 1996) 45

Me Pub. Serv. Co. v. FERC,
964 F.2d 5 (D.C. Cir. 1992) 40

Mobil Oil Corp. v. Higginbotham,
436 U.S. 618 (1978) 35

Morgan v. Ponder,
892 F.2d 1355 (8th Cir. 1989) 40

N. Haven Bd. of Educ. v. Bell,
456 U.S. 512 (1982) 33

National R.R. Passenger Corp. v. Boston & Me. Corp.,
503 U.S. 407 (1992) 26

Natural Res. Def. Council v. Browner,
57 F.3d 1122 (D.C. Cir. 1995) 32

**Natural Resources Defense Council, Inc. v. Daley*,
209 F.3d 747 (D.C. Cir. 2000) 26, 36, 44, 56

Nuclear Energy Inst., Inc. v. EPA,
373 F.3d 1251 (D.C. Cir. 2004) 36

Qwest Corp. v. FCC,
258 F.3d 1191 (10th Cir. 2001) 39

Ry. Labor Execs. Ass'n v. National Mediation Bd.,
29 F.3d 655 (D.C. Cir. 1994) 32

San Antonio, Tx. Acting By & Through Its City Pub. Serv. Bd. v. United States,
631 F.2d 831 (D.C. Cir. 1980) 39

SEC v. Chenery Corp.,
332 U.S. 194 (1947) 24

Sec'y of Labor v. Fed. Mine Safety & Health Review Comm'n,
111 F.3d 913 (D.C. Cir. 1997) 23

**Southern Cal. Edison Co. v. FERC*,
195 F.3d 17 (D.C. Cir. 1999) 20, 25, 31-32

TCF National Bank v. Bernanke,
643 F.3d 1158 (8th Cir. 2011) 24

Trans Union LLC v. FTC,
295 F.3d 42 (D.C. Cir. 2002)..23

United States v. Bass,
404 U.S. 336 (1971)...30

United States v. Indoor Cultivation Equip. From High Tech Indoor Garden Supply,
55 F.3d 1311 (7th Cir. 1995) 29

**United States v. Locke*,
471 U.S. 84 (1985)..35, 38

Vill. Of Barrington, Ill. v. Surface Transp. Bd,
635 F.3d 650 (D.C. Cir. 2011)..39

Whitman v. American Trucking Ass'ns,
531 U.S. 457 (2001)...41

STATUTES

5 U.S.C. § 706 (2006) 5, 23

15 U.S.C. § 1693o-2 (Supp. IV 2010)
.... 1-3, 6, 8, 11-13, 15-22, 26-31, 34-44, 46, 48, 50-55

LEGISLATIVE MATERIALS

156 Cong. Rec. S3,695, S3,704 (daily ed. May 13, 2010) 34, 53

156 Cong. Rec. S5,802 (daily ed. July 14, 2010)...9

156 Cong. Rec. S5,925-26 (daily ed. July 15, 2010)....................... 28, 33, 42, 53-54

H.R. Conf. Rep. No. 111-517 (2010)..53

RULES

Fed. R. Civ. P. 56 23

CODE OF FEDERAL REGULATIONS

12 C.F.R. § 235.3 15

12 C.F.R. § 235.7 ....16, 45

BOOKS AND ARTICLES

Adam J. Levitin, *Cross Routing: PIN and Signature Debit Interchangeability Under the Durbin Amendment,* 2 LYDIAN J 16 (Dec. 2010) 49-50

Black's Law Dictionary (6th ed. 1990)..36, 40

Merriam-Webster's Collegiate Dictionary (11th ed. 2009) 28

Webster's New College Dictionary (2007) 28, 36

William Strunk Jr. & E.B. White, *The Elements of Style* (3d ed. 1979)..................29

GLOSSARY

Abbreviations	*Definitions*
ACS	Authorization, Clearance, or Settlement
APA	Administrative Procedure Act
NPRM	Notice of Proposed Rulemaking
PIN	Personal Identification Number

STATEMENT OF ISSUES PRESENTED

1. Whether the District Court properly concluded that the Board of Governors of the Federal Reserve System acted arbitrarily, capriciously, and in excess of its statutory authority when it adopted debit interchange transaction fee standards that permitted debit card issuing banks to recover fees from merchants well beyond those allowed by Congress in the Durbin Amendment to the Consumer Financial Protection Act of 2010, 15 U.S.C. § 1693o-2(a)(4)(B).

2. Whether the District Court properly concluded that the Board acted arbitrarily, capriciously, and in excess of its statutory authority in implementing the Durbin Amendment's network non-exclusivity requirement—which provides that payment card networks and issuing banks may not limit the number of payment card networks on which "an electronic debit transaction" may be processed to fewer than two unaffiliated networks, 15 U.S.C. § 1693o-2(b)(1)(A)—by adopting a regulation that requires only that each debit *card* must be enabled for multiple unaffiliated networks, ensuring that merchants will not realize competitive network choice in a large number of electronic debit transactions.

PERTINENT STATUTES & REGULATIONS

Applicable statutes and regulations are reproduced in an Addendum to this Brief.

STATEMENT OF THE CASE

This case stems from Congress's efforts to alleviate the burden to merchants of rising debit card fees and the subsequent failure of the defendant Board of Governors of the Federal Reserve System (the "Board") to implement Congress's explicit directions. As debit cards have become a predominant method of payment, debit card networks (*e.g.*, Visa and MasterCard) and their issuing banks have steadily increased two particular categories of debit card fees: (a) "interchange" fees (popularly known as "swipe fees"), *i.e.*, the fees that debit card issuing banks charge merchants for the banks' role in a debit transaction, and (b) "network fees" (also called "switch fees"), *i.e.*, the fees charged by the debit card networks for their role in processing the transaction.

Congress sought to curb these escalating debit card fees in the Durbin Amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Section 920 of the Electronic Fund Transfer Act, codified at 15 U.S.C. § 1693o-2). The Durbin Amendment directed the Board to adopt regulations to rein in debit fees in the two provisions at issue here.

First, the statute directs the Board to adopt interchange fee standards requiring that these fees be reasonable and proportional to the costs incurred by an issuing bank with respect to the debit transaction. In establishing these standards, the Durbin Amendment requires the Board to "distinguish between" two categories of debit transaction costs: (a) the "incremental cost" incurred by an issuer for its role in the authorization, clearance or settlement ("ACS") of a particular debit transaction, which must be included in the interchange fee standard, and (b) "other

costs" incurred by an issuer which are not "specific" to a "particular electronic debit transaction," which must be excluded. 15 U.S.C. § 1693o-2(a)(4)(B).

Second, the Durbin Amendment addressed network fees by seeking to enhance the competitive network choices available to merchants at the point of sale. The statute directed the Board to promulgate rules prohibiting networks and issuing banks from maintaining practices that limit the number of networks on which a debit transaction may be processed to less than two unaffiliated networks. *Id.* § 1693o-2(b)(1).

In December 2010, the Board published a Notice of Proposed Rulemaking ("NPRM"). With respect to interchange fees, the NPRM proposed to set a fee standard that allowed issuing banks to recover only those costs that "are specifically mentioned for consideration in the statute" and excluded all other costs. JA110-11. Based on industry data regarding allowable cost components, the Board proposed two alternative fee standards, permitting banks to recover interchange fees in amounts ranging from 7 cents to 12 cents per transaction. JA113-14.

After significant pushback from banks during the comment period, the Board reversed course and adopted a Final Rule greatly expanding allowable costs. *See* JA140. The Board determined that it was not required even to identify, let alone to distinguish between, costs that the statute required it to include and those that the statute required it to exclude. It declined to interpret many of the statute's limiting terms, refusing to identify which costs are "incremental," or "incurred in connection with authorization, clearance and settlement" and thus includable in the

fee standard. JA173. In the Board's view, the statute's requirement that the Board exclude "other" costs "not *specific* to a *particular* transaction," required it to exclude only a narrow category of costs not "specific to effecting debit card transactions *as a whole*." JA172 (emphasis added).

Based on this puzzling interpretation, the Board determined that it could consider any costs not explicitly excluded from consideration by Congress. JA53. It invented a third category of costs—those that *are* specific to debit transactions as a whole (and not excluded under the Board's interpretation), but not among the "incremental" ACS costs required to be included by the statute (but left undefined and unidentified by the Board). *Id.* As a result, it included in the final fee standard a number of costs (*e.g.*, fixed costs and fraud losses) that it had proposed to exclude in the NPRM. *Id.* The Board's Final Rule *as much as tripled* allowable interchange fees from the NPRM's standard, setting an allowable fee of 21 cents plus a 5-basis-point *ad valorem* adjustment.

In implementing network non-exclusivity, the Board required that issuers maintain two unaffiliated networks on *each debit card* issued to consumers, rather than requiring that two unaffiliated networks be available for each *transaction*. It concluded that an issuer may comply with the network non-exclusivity provision by maintaining a single network on each card for each method of debit card authentication—signature and personal identification number ("PIN") authentication. The Board acknowledged, however, that large categories of *transactions,* such as hotel stays, car rentals and most internet transactions, cannot

be processed by PIN—and that the vast majority of U.S. merchants are not enabled to accept PIN transactions. JA141.

Plaintiffs are a group of individual merchants and trade associations representing merchants that accept debit cards (*e.g.*, convenience stores, grocery stores and restaurants) and pay significant debit card fees. *See* JA38. They challenged the Board's Final Rule in the District Court, alleging that the interchange fee standard and network non-exclusivity rules were arbitrary, capricious and in excess of the Board's statutory authority in violation of the APA, 5 U.S.C. § 706(2)(a), (c).

On cross motions for summary judgment, the District Court concluded that "the Board has clearly disregarded Congress's statutory intent by inappropriately inflating all debit card transaction fees by billions of dollars." JA37-38. It granted Plaintiffs' motion and denied the Board's motion, declaring that the two challenged regulatory provisions violated the APA. It subsequently stayed its ruling, and the Board appealed. JA96.

STATEMENT OF FACTS

I. Debit Cards and Debit Card Networks

Debit cards provide an additional means—other than checks and in-person withdrawals—by which consumers can access funds in their bank deposit accounts. JA141. Debit cards operate like an electronic check, accessing funds in a consumer's deposit account when presented for payment to the merchant at the point of sale. *Id.* In recent years, they have "eclipsed checks as the most

frequently used noncash payment method," estimated to account for about 50 billion transactions in 2011 alone. *Id.*

A typical debit transaction involves the network that processes the transaction and four other parties: (1) the consumer, who presents a debit card for payment; (2) the issuing bank, the depository institution that holds the consumer's account and issues the debit card to the consumer (*see* 15 U.S.C. § 1693o-2(c)(9)); (3) the merchant, which accepts payment by debit card; and (4) the merchant's bank (also known as the acquiring bank), which facilitates the authorization, clearance and settlement of a debit transaction on behalf of the merchant. JA141. The network provides the infrastructure and software for routing data for debit card authorization, clearance, and settlement. *See* 15 U.S.C. § 1693o-2(c)(11). It receives transaction information from the merchant and the merchant's bank, routes the information to the issuer bank, and determines each side's daily settlement position for interbank monetary transfers. JA141.

There are two categories of debit transactions, depending on how the transaction is initiated and authenticated by the consumer: PIN and "signature." These transactions have historically been processed over entirely separate networks, stemming from the separate evolution of the network infrastructure. *Id.*

PIN debit networks evolved from ATM networks, and include networks operated by Visa (Interlink and Plus), MasterCard (Maestro), Discover (Pulse), and independent networks (*e.g.*, NYCE, STAR and Shazam). *Id.* In a PIN-debit transaction, the consumer typically enters a PIN to authorize the transaction, and

the transaction authorization and clearance are included in a single electronic message. JA141.

Signature debit networks sprung from Visa and MasterCard's credit card network infrastructure. *Id.* Those networks are the dominant signature card networks, accounting for over 80% of all debit transactions and for virtually all signature interchange fees. JA296. In a signature transaction, the consumer often signs a receipt. JA141. Signature debit transactions are usually dual-message transactions, in which authorization is carried in one message and clearing information is carried in a subsequent message. *Id.*

Most debit cards issued by banks covered by the Durbin Amendment are configured to support both PIN and signature transactions. *Id.* But not all transactions can be paid for through either method of authentication. Certain transactions, such as hotel stays and car rentals, cannot generally be accommodated in PIN-transactions because the exact amount of the transaction cannot be known at the time of authorization (when clearance information is also sent in a PIN transaction). *Id.* Similarly, PIN-based debit payments generally cannot be accepted for Internet, mail order or phone purchases. *Id.* The Board estimated that only "one-quarter of the merchant locations in the United States that accept debit cards have the capability to accept PIN-based debit transactions." *Id.*; JA41.

II. The Rise in Debit Card Fees

There are various fees associated with debit transactions. The largest—the interchange fee—is set by the networks to compensate issuing banks for their involvement in electronic debit transactions. JA142; *see also* 15 U.S.C. § 1693o-2(c)(8). The interchange fee is borne by the merchants. JA99. The networks also charge network fees, which are paid by issuing and acquiring banks "to compensate the network for its role in processing the transaction." JA142; *see* 15 U.S.C. § 1693o-2(c)(10).

In the early days of debit transactions, issuing banks generally did not charge interchange fees to merchants. Because debit transactions were much cheaper for banks to process than checks or paper withdrawals, many networks paid merchants to install equipment to process those transactions. JA42, JA142. Many banks also profitably provided debit services without charging any interchange, a model that prevailed until the early 1990s and resulted in widespread expansion of debit card services. JA42, JA142, JA451.

As debit cards became more prevalent, networks began to add interchange fees to entice banks to issue their cards. JA142. Since the late 1990s, those interchange fees have skyrocketed. Visa and MasterCard "leverage[d their existing] credit card network infrastructure" to build a dominant market position in the debit card market. *See* JA141. As explained in comments filed by merchants' groups, "merchants faced market-wide effective interchange increases of an estimated 234% between 1998 and 2006." JA42, JA452.

For most retailers, interchange fees have become a significant operational expense. For example, payment card costs, "with interchange as the largest component, represents the single largest operating expense in [the convenience store] industry behind payroll expense, and is forecast to have cost the industry $8.9 billion in 2010." JA536. Debit card interchange grew by 8.1% annually for convenience store operators represented by NACS between 2007 and 2010. *Id.*

This sharp and steady rise in interchange fees was due, in large measure, to the absence of competition. Issuing banks all receive the same fees for Visa and MasterCard debit transactions because the fee schedules are set by the networks. JA142. 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." JA434.

The lack of competition between banks resulted in upward pressure on interchange fees, as networks attracted more banks to issue cards by increasing interchange fees. Because accepting payment cards has become an operational necessity, merchants have little leverage to negotiate with the networks and issuers with respect to interchange fees. *See* JA43; *see also* JA309-12; 156 Cong. Rec. S5,802 (daily ed. July 14, 2010) (statement of Sen. Richard J. Durbin). Visa and MasterCard, in turn, used their market power in the credit card market to grab a dominant share of the debit card market, forcing merchants to accept their debit cards as a condition of accepting their prominent credit cards—practices that are now the subject of an antitrust consent decree. *See In re Visa Check/MasterMoney*

Antitrust Litigation, 192 F.R.D. 68 (E.D.N.Y. 2000), *aff'd*, 280 F.3d 124 (2d Cir. 2001); JA304-05.

At the same time that they increased interchange fees for the benefit of issuing banks, the major networks also rapidly escalated their own network fees. Visa and MasterCard operating rules have long prohibited any other network from handling signature transactions on their cards, permitting limited network competition only for PIN transactions.[2] Visa and MasterCard were able to dramatically increase network fees without fear of losing transaction volume because merchants had few, if any, alternatives for routing the transactions. *See* JA307-15.

III. The Durbin Amendment

In July 2010, Congress enacted the Durbin Amendment to address the rapid escalation of debit fees. The statute addressed debit interchange transaction fees and network fees in different manners. For interchange fees, the statute directed the Board to establish specific standards governing those fees. For network fees, the statute did not establish a similar fee standard, but sought instead to increase competition and merchant choice among networks.

---

[2] The networks sought to squelch even this competition through exclusivity agreements providing revenue to issuers if they included only that network's affiliated PIN network on debit cards. JA307.

A. The Interchange Fee Standard

The Durbin Amendment requires that 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 costs incurred by the issuer with respect to the transaction, and directs the Board to promulgate regulations establishing "standards for assessing whether the amount of any interchange transaction fee" meets this requirement. 15 U.S.C. § 1693o-2(a)(2), (3).

In prescribing these regulations, Congress required the Board to take into account certain statutory "[c]onsiderations." *Id.* § 1693o-2(a)(4). First, it must "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," *i.e.,* at face value with no transactions fees. *Id.* § 1693o-2(a)(4)(A). Next, to create a closer equivalency between the debit card system and the checking system in which transactions are required to clear at par, JA435, Congress directed the Board to "distinguish between" two categories of cost items:

> (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)[.]

Id. § 1693o-2(a)(4)(B).

Once the Board determines a reasonable interchange transaction fee standard, Congress permits the Board to allow a separate "fraud-related adjustment" to that fee. *See* 15 U.S.C. § 1693o-2(a)(5). This issuer-specific adjustment is permitted only where it is "reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud" and where the issuer has complied with fraud-prevention standards adopted by the Board. *Id.* § 1693o-2(a)(5)(A). The statute provides that "any fraud-related adjustment to the issuer is limited to the amount described" in this section (*i.e.*, a reasonable allowance for costs of "preventing fraud"). *Id.* § 1693o-2(a)(5)(A)(ii)(I).

B. Network Fee Regulation

The Durbin Amendment explicitly withholds from the Board similar standard-setting authority over network fees. Instead, the statute addressed the problem of rising network fees through a market-oriented approach, adopting a pair of restrictions designed to expand the range of networks through which merchants may route transactions. *See* 15 U.S.C. § 1693o-2(b). First, the statute requires the Board to promulgate regulations providing that issuers or payment card networks shall not "restrict the number of payment card networks on which an electronic debit *transaction* may be processed" to—

> (i) 1 such network; or
>
> (ii) 2 or more such networks which are owned, controlled, or otherwise operated by—
>
> > (I) affiliated persons; or
> >
> > (II) networks affiliated with such issuer.

Id. § 1693o-2(b)(1)(A) (emphasis added).

Second, the statute directs the Board to prescribe regulations that prevent networks and issuers from imposing network routing restrictions on merchants. It prohibits networks and issuers from "inhibit[ing] the ability of any person who accepts debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions." *Id.* § 1693o-2(b)(1)(B).

IV. The Board's Proposed Rule

To formulate its proposed rule, the Board collected cost information from networks and banks. It calculated that the median issuer per-transaction variable processing cost for a debit transaction was 7.1 cents for all debit transactions, and the median total processing cost, including fixed and variable costs was 11.9 cents. JA101.

The Board proposed an interchange fee standard that included "only those costs that are specifically mentioned for consideration in the statute." JA110-11. It proposed to limit recovery to costs "associated with authorization, clearing, and settlement of a transaction" that vary with the number of transactions sent to the issuer within the reporting year. *See* JA50, JA111.

Based on "the statute's mandate to consider the functional similarities between debit transactions and check transactions," the Board explicitly rejected other costs associated with a particular transaction. JA111. The Board proposed to exclude fixed costs and overhead costs, reasoning that those costs are "common to all debit transactions and thus could never be attributed to any *particular*

transaction . . . , even if those costs are specific to debit card transaction as a whole." JA112. The Board also proposed to exclude fixed costs common to all debit transactions, fraud losses and an issuer's network fees from allowable costs. JA50, JA112, JA136.

In light of these cost considerations, the Board proposed two alternative standards for public comment. Alternative 1 was an issuer-specific standard with both a safe harbor and a cap, which allowed each issuer to recover its actual incremental ACS costs, up to a cap of 12 cents per transaction. If an issuer chose not to determine its individual allowable costs, it could collect a safe harbor interchange fee up to 7 cents. JA112-14. Alternative 2 simply set a safe harbor and cap at 12 cents per transaction. JA114.

The Board also offered two alternative approaches for implementing the restrictions on network exclusivity. JA125. Alternative A required that at least two unaffiliated networks be made active on each debit card. *Id.* An issuer could comply with this requirement by having one card network available for signature debit transactions and a second, unaffiliated network available for PIN debit transactions. *Id.* Alternative B required that a debit card have at least two unaffiliated networks available for each method of authorization available to the cardholder. JA126.

V. The Final Rule

On July 20, 2011, the Board released the Final Rule, with an effective date of October 1, 2011. *See* JA140.

<u>The Interchange Fee Standard</u>. With respect to the interchange fee standard, the Board rejected both of its proposed alternatives and adopted a cap of 21-cents plus an *ad valorem* amount of 5 basis points of the transaction's value (0.05%). 12 C.F.R. § 235.3. For the average transaction, the Final Rule nearly *doubled* the interchange fee allowed as compared to the maximum 12 cents allowable under the NPRM.

The Board reached this drastically different outcome by rejecting its prior statutory interpretation. The Board complained that its NPRM, which "prohibits consideration of all costs that are not able to be specifically identified to a given transaction[,] would appear to exclude almost all costs related to electronic debit transactions because very few costs could be specifically assigned to a given transaction." JA172. The Board interpreted costs "*specific* to a *particular* electronic debit transaction" to mean costs "specific to effecting debit transactions *as a whole*." *Id.* (emphasis added). It limited the excluded costs under 15 U.S.C. § 1693o-2(a)(4)(B)(ii) to "those costs that are not incurred in the course of effecting any electronic debit transaction." *Id.*

Only after adopting this narrow interpretation of excludable costs, the Board concluded that the statute is actually "silent" on a third category of costs—"those that are specific to a particular electronic debit transaction but that are not incremental costs related to the issuer's role in authorization, clearance, and settlement." JA172. The Board claimed discretion to decide which costs in this "silent" third category it would allow. It reasoned "*all* costs related to a particular transaction *may* be considered, and some—the incremental costs incurred by the

issuer for its role in authorization, clearance, and settlement—*must* be considered." JA173 (emphasis added). This interpretation "would not require identification of the cost of a given electronic debit transaction." JA172. Thus, the "Board does not find it necessary to determine whether costs are 'incremental,' fixed or variable, or incurred in connection with authorization, clearance, and settlement." JA173.

Claiming broad discretion, the Board permitted recovery of a range of costs that had been proposed for exclusion in the NPRM, including: (1) fixed costs related to authorization, clearance, and settlement, (2) network processing fees, and (3) transactions monitoring costs (a common fraud prevention cost). JA175-76. The Board also permitted a 5-basis-points *ad valorem* charge to permit issuers an allowance for fraud losses. JA177.

Network Non-Exclusivity. In implementing 15 U.S.C. § 1693o-2(b)(1)(A), the Board concluded that "[t]he plain language of the statute does not require that there be two unaffiliated payment card networks available to the merchant for each method of authentication." JA193. It reasoned that "the statute does not expressly require issuers to offer multiple unaffiliated signature *and* multiple unaffiliated PIN debit card network choices on each card." *Id.* (emphasis added). It therefore required only that all debit *cards* be interoperable with at least two unaffiliated networks. 12 C.F.R. § 235.7(a)(2) & Official Cmt. 1. The Final Rule permits a bank to comply by providing only one network choice for signature transactions and one network choice for PIN transactions—leaving merchants without competitive options under the rule in a large number of transactions, and, in

particular, the 75% of merchants that do not process PIN transactions, with one network choice on all of their transactions. JA141.

VI. The District Court's Decision

In November 2011, Plaintiffs, a group of merchants and merchant trade associations directly affected by the Final Rule, filed a complaint alleging that the Board's interpretation of the fee standard and network non-exclusivity provisions violated the plain language of the Durbin Amendment and were invalid under the APA. *See* JA1. On cross-motions for summary judgment, the District Court concluded that the interchange transaction fee and network non-exclusivity regulations are "fundamentally deficient," reasoning that "the Board completely misunderstood the Durbin Amendment's statutory directive and interpreted the law in ways that were clearly foreclosed by Congress." JA91.

With respect to the interchange fee standard, the Court concluded that the statute requires that the Board consider only incremental ACS costs and exclude all other costs. JA62. The Court determined it had "*no* difficulty concluding that the statutory language evidences an intent by Congress to bifurcate the entire universe of costs associated with interchange fees." JA64 (emphasis in original). It reasoned that Congress excluded from consideration all costs other than an issuer's variable ACS costs relating to a particular debit transaction. JA68-69.

Applying the ordinary meaning of the statute's terms, the Court interpreted Congress's exclusion of "other costs . . . not *specific* to a *particular* transaction," 15 U.S.C. § 1693o-2(a)(4)(B)(ii), to require exclusion of "'other costs . . . which are not [unique] to a [distinct or individual] transaction.'" JA69. The Board's

contrary interpretation "ignored critical statutory terms" and distorted the statute's description of excluded costs beyond recognition. "Costs that are 'not specific *to a particular debit transaction*,' § 1693o-2(a)(4)(B)(ii) (emphasis added), simply are not the same as costs that are 'not specific *to debit transactions as a whole*." JA76.

The Court concluded that the Board's theory that it could consider "any cost that is not prohibited" is "irreconcilable with the statute" on its face. The Board claimed authority over non-prohibited costs by "improperly narrowing the scope of *excluded* costs." JA75. Thus, the Board factored four costs into the interchange fee standard that the statute expressly prohibits, including (1) fixed ACS costs, (2) transaction monitoring costs, (3) fraud losses, and (4) network processing fees. JA77-80.

As to the network non-exclusivity regulation, the Court concluded that the statute plainly requires merchants to be given a choice between multiple unaffiliated networks for each *transaction*. JA83-84. Citing the plain language, the Court rejected the Board's argument that the statute "is silent as to whether merchants must have routing choices for each transaction." JA84-85. The court found support for this plain reading in legislative history, which confirmed that "Congress adopted the network non-exclusivity and routing provisions to ensure that for [sic] multiple unaffiliated routing options were available for each debit card transaction, *regardless of the method of authentication*." JA87 (emphasis added).

The Court vacated the Board's interchange fee standard and non-exclusivity regulations and remanded to the Board for further proceedings. JA91. In a subsequent order, it stayed its ruling pending appeal. JA96-97.

SUMMARY OF ARGUMENT

The District Court correctly held that the Board's interchange fee standard and non-exclusivity rule were inconsistent with the plain text, purpose, and legislative history of the Durbin Amendment and were thus invalid under *Chevron, U.S.A., Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

Interchange fee standard. The Board's interpretation of the Durbin Amendment's interchange fee standard, 15 U.S.C. § 1693o-2(a), fails to implement the plain letter of the Durbin Amendment and is invalid under *Chevron*'s first step. The Durbin Amendment sought to curb rapidly escalating debit card fees by limiting allowable interchange fees to an issuing bank's "incremental cost" for its role authorizing, clearing or settling a particular transaction. The statute did so by requiring the Board to promulgate regulations to ensure that debit interchange fees were "reasonable and proportional to the cost incurred by the issuer with respect to the transaction." *Id.* § 1693o-2(a)(2). In prescribing these regulations, the Board was required to "distinguish between" two categories of costs: (1) the issuer's "incremental cost" for its role in authorizing, clearing or settling a "particular" transaction, which the statute instructed the Board to include in the interchange fee standard; and (2) "other costs incurred by an issuer which are not specific to a particular electronic debit transaction," which the statute excluded from consideration.

Despite the clear dichotomy of includable and excludable costs established by Congress, the Board claims that the statute is actually silent and thus ambiguous with respect to a third category of costs. It claims broad discretion to consider any cost not expressly excluded by the statute, which it describes as any cost "specific to a particular transaction," but not explicitly within the includable cost provision of Section 920(a)(4)(B)(i). Where the statute explicitly directs it to include the "incremental cost" of authorization, clearance and settlement of a particular transaction, the Board claims the authority to include in its standard the "non-incremental" (*i.e.*, fixed) cost and other costs (*e.g.*, an issuer's fraud losses) beyond those explicitly provided for by the statute.

The Board creates this "silent" third category of costs only by ignoring and contorting the statute's critical limiting language. It disregards entirely the limiting characteristics of costs that Congress directed it to include in the standard, declining to define those statutory terms or even identify what costs fall within Section 920(a)(4)(B)(i). JA172-73. The Board concludes that Congress limited the costs includable in the interchange fee standard only to allow the Board, by virtue of claimed statutory silence, to include other costs that plainly fail to meet those criteria. This Court has "repeatedly rejected the notion that the absence of an express proscription allows an agency to ignore a proscription implied by the limiting language of a statute." *See, e.g.*, *Southern Cal. Edison Co. v. FERC*, 195 F.3d 17, 24 (D.C. Cir. 1999).

The Board's erroneous conclusion that the statute is "silent" with respect to a third category of costs also depends heavily on its misconstruction of the

excludable cost provision of Section 920(a)(4)(B)(ii), which mandates that the fee standard exclude all "other costs incurred by an issuer which are not specific to a particular electronic debit transaction." The Board contorts this critical language to exclude a much narrower group of costs "not specific to debit transactions *as a whole*," JA172—just the opposite of what the statute commands. It adopts this interpretation despite its recognition that when Congress wanted to address costs associated with debit transactions *generally*, it used much different language than the individual transaction-specific language used in Section 920(a)(4)(B). Appellant Br. 65-66. The District Court properly rejected the Board's construction of Section 920(a)(4)(B)(ii), reasoning that "[c]osts that are 'not specific to a *particular transaction*' . . . , simply are not the same as costs that are 'not specific *to debit transactions as a whole*.'" JA76.

Accordingly, the statute is neither *silent* nor *ambiguous* with respect to the Board's third category of costs. The plain language of Section 920(a)(4)(B)(ii) is reinforced by the statute's legislative history. Senator Durbin explained in floor debates prior to passage of the Amendment bearing his name that the statute was designed to permit recovery of *only* those incremental costs for the issuer's role in the authorization, clearance and settlement of a particular transaction and to exclude *all* others. JA31.

Given the shaky foundation on which the Final Rule rests, it is no surprise that several particular costs allowed therein are explicitly forbidden by the Durbin Amendment. The vast majority of additional costs permitted by the Board's expansive interpretation of allowable costs—such as fixed equipment, hardware

and software costs—are incurred by issuing banks whether or not a "particular" transaction ever takes place. In a similar vein, the Board's allowance of both fraud prevention costs (*i.e.*, transactions monitoring) and fraud losses conflicts with Congress's determination to treat fraud prevention costs as part of a separate, post-interchange fee adjustment and to foreclose entirely the recovery of fraud losses from that adjustment. *See* 15 U.S.C. § 1693o-2(a)(5).

Because it is inconsistent with the plain language, structure, history and purpose of the statute, the Board's interchange fee standard must be invalidated.

Network Non-Exclusivity: The Board's implementation of the statute's non-exclusivity requirement suffers similar infirmities. The statute clearly requires that the Board prohibit networks and issuers from restricting the "networks on which *an electronic debit transaction* may be processed" to less than two unaffiliated networks. 15 U.S.C. § 1693o-2(b)(1)(A) (emphasis added). Yet the Board's regulation permits card networks and issuers to limit the transactions that competing networks can handle—for example, network rules that prohibit PIN networks from handling signature transactions—such that only one routing choice is available on a large number of transactions. In a statement on the Senate floor, Senator Durbin made clear that the network choice required by the statute must be available regardless of the method of authentication used for a particular transaction. The Board's implementation of Section 920(b) conflicts with the statute's plain language, fails to advance the statute's central purpose, and must be invalidated.

ARGUMENT

I. Standard of Review

The APA requires this Court to "hold unlawful and set aside agency action, findings and conclusions found to be . . . (A) arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law [or] . . . (C) in excess of statutory jurisdiction, authority or limitations, or short of statutory right." 5 U.S.C. § 706(2) (2006). "Regardless of how serious the problem an administrative agency seeks to address, . . . it may not exercise its authority 'in a manner that is inconsistent with the administrative structure that Congress enacted into law.'" *FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125 (2000) (citation omitted).[3]

The correct interpretation of the Durbin Amendment is a legal question ultimately committed to this Court by the APA. 5 U.S.C. § 706. Review of the Board's statutory interpretation is guided by the familiar two-pronged *Chevron* analysis. *See* 467 U.S. at 842. The Court first asks "whether Congress has directly spoken to the precise question at issue"; if so, it must give effect to Congress's unambiguously expressed intent. *Id.* at 842-43; *see Sec'y of Labor v. Fed. Mine*

---

[3] Review of the District Court's summary judgment ruling is *de novo,* applying the same standards applied by the District Court. *Trans Union LLC v. FTC*, 295 F.3d 42, 48 (D.C. Cir. 2002). Summary judgment is appropriate when "there is no genuine dispute as to any material fact" and "the [moving party] is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c).

Safety & Health Review Comm'n, 111 F.3d 913, 917 (D.C. Cir. 1997). The court owes no deference to the agency's determination that a statute is ambiguous. *See, e.g.*, *ABA v. FTC*, 430 F.3d 458, 468 (D.C. Cir. 2005). If the court determines that a statute is silent or ambiguous with respect to the specific question over which the agency has claimed authority, it will review the agency's interpretation to determine whether it is reasonable and consistent with the statute's purpose. *Chevron*, 467 U.S. at 842-43.

In a challenge to agency rulemaking, a court may not consider rationales beyond those adopted by the agency. *SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947). If the basis for the Board's action is "inadequate or improper, the court is powerless to affirm the administrative action by substituting what it considers to be a more adequate or proper basis." *Id.*[4]

---

[4] For this reason, bank *amici*'s constitutional avoidance argument is improper. *See* Brief for *Amici Curiae* The Clearing House Ass'n *et al.* 21-22 ("Bank *Amici* Br."). In any event, the Eighth Circuit rejected an identical constitutional challenge to the Durbin Amendment in *TCF National Bank v. Bernanke*, 643 F.3d 1158 (8th Cir. 2011), on a much more developed factual record than offered by *amici*. There simply is no serious constitutional question to avoid in this case. Nor could any such considerations vary the plain language of the statute.

II. The Final Rule's Interchange Fee Standard Violates the APA

Signaling a lack of confidence in the legality of its interchange fee standard, the Board opts to open its brief by defending its network non-exclusivity provision. Both provisions are important to the merchant plaintiffs, their customers and the U.S. economy. As a result of the Board's unlawful interpretation, merchants pay an inflated interchange fee with every debit transaction. Plaintiffs estimated below that merchants and their consumers are forced to pay more than $4 billion per year in interchange in excess of the amount originally proposed in the NPRM. *See* ECF No. 20 at 45 & n.13. Given the importance of the interchange fees, Plaintiffs will, as they (and the District Court) did below, address first the invalidity of the Board's interchange fee standard.

A. The Board's Interpretation of Its Interchange Fee Authority Fails at *Chevron* Step One

The District Court properly determined that the Board's final interchange fee standard "clearly disregarded Congress's statutory intent." JA37-38. Because Congress has plainly foreclosed the interpretation adopted by the Board, the interchange fee standard cannot survive scrutiny under the first prong of *Chevron*. *See Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000) (where "the statute's language is plain, the sole function of the courts . . . is to enforce it according to its terms").

The focal point of *Chevron*'s first step is the language of the statute itself. *See Southern Cal. Edison Co.*, 195 F.3d at 22-23. Judicial deference is due only "[i]f the agency interpretation is not in conflict with the plain language of the

statute." *National R.R. Passenger Corp. v. Boston & Me. Corp.*, 503 U.S. 407, 417 (1992). The Court must further exhaust traditional tools of statutory construction, examining the language, structure, purpose, and legislative history of the statute to determine whether Congress has spoken to the precise question at issue. *See Petit v. U.S. Dep't of Educ.*, 675 F.3d 769, 781 (D.C. Cir. 2012); *Bell Atlantic Telephone Companies v. FCC,* 131 F.3d 1044, 1047 (D.C. Cir.1997). If "Congress has expressed its intention as to the question, [then] deference is not appropriate." *Natural Resources Defense Council, Inc. v. Daley*, 209 F.3d 747, 752 (D.C. Cir. 2000).

1. The Durbin Amendment Plainly Limits Allowable Costs to Those Costs Specifically Delineated in 15 U.S.C. § 1693o-2(a)(4)(B)(i)

The plain language of the Durbin Amendment does not grant the Board the discretion it claims to consider costs beyond those delineated in Section 920(a)(4)(B) of the statute. 15 U.S.C. § 1693o-2(a)(4)(B). The statute explicitly directs the Board to ensure that any interchange fee charged by an issuing bank "is reasonable and proportional to the cost incurred by the issuer with respect to the transaction." *Id.* § 1693o-2(a)(3). The Board and bank *amici* argue that the "cost incurred by the issuer" is left undefined by the statute and leaves the Board discretion to include any "cost" not specifically excluded by the statute. Appellant Br. 44; Bank *Amici* Br. at 12-14. But they get to that conclusion only by disregarding—or relegating to a "subsidiary 'consideration'"—Congress's very

specific statutory direction as to which costs the Board should and should not take into account in setting the standard. *See* Bank *Amici* Br. 14.

Specifically, Congress directed the Board, in adopting its interchange fee regulations, to take into account statutory "considerations." 15 U.S.C. § 1693o-2(a)(4). Chiefly, Congress required the Board to "distinguish between" two categories of costs: (1) "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" in the standard; and (2) "other costs incurred by an issuer which are not specific to a particular electronic debit transaction, which costs shall not be considered." *Id.* § 1693o-2(a)(4)(B).

Thus, the statute does not leave undefined the phrase "costs incurred by the issuer with respect to the transaction." Appellant Br. 44. The Board's assertion that the statute provides only "limited guidance regarding the factors the Board should consider," *id.*, is mystifying, since the statute sets out in detail the relevant "considerations," including cost considerations, in Section 920(a)(4). Those cost "considerations" quite plainly limit the Board's discretion in developing the fee standard to those cost factors explicitly spelled out by Congress. *See American Petroleum Institute v. EPA*, 706 F.3d 474, 479 (D.C. Cir. 2013) ("a broad programmatic objective cannot trump specific instructions"); *Cf. Entergy Corp. v. Riverkeeper, Inc.*, 556 U.S. 208, 221 (2009) (statutory clean water standards "are elucidated by statutory factor lists that guide their implementation").

Section 920(a)(4)(B) establishes a clear dichotomy between costs "that *must be included* in the interchange fee standard and 'other costs that *must be excluded*."

JA65 (emphasis added). This language was intended to encompass the entire universe of costs that the Board could consider in setting the fee standard. *See* 156 Cong. Rec. S5,925 (daily ed. July 15, 2010) (statement of Sen. Richard J. Durbin).

That conclusion is reinforced by the specific language that Congress chose. *See* JA65-67. First, Congress directed the Board to "distinguish between"—and thus differentiate—the two categories of costs. *See Webster's New College Dictionary* 417 (2007) (defining "distinguish as "to separate or mark off by differences; perceive or show the difference in; differentiate"); JA65 & n.27. To be includable in the fee standard, costs must satisfy a number of a criteria—they must be "incremental," incurred by the issuing bank for its role in "authorization, clearance, or settlement," and stem from a "particular electronic debit transaction." 15 U.S.C. § 1693o-2(a)(4)(B)(i).

From those specifically defined includable costs, the statute then directs the Board to differentiate all "other costs," which the Board *shall not* consider in setting the standard. *Id.* § 1693o-2(a)(4)(B)(i). The very use of the term "other costs"—as opposed to simply "costs"—indicates the entire universe of costs that is remaining after consideration of includable costs. JA65-66 (citing *Merriam-Webster's Collegiate Dictionary* 878-79 (11th ed. 2009) (defining "other" as "being the one (as of two or more) remaining or not included; being the one or ones distinct from that or those first mentioned or implied")). The plain text indicates that "incremental ACS costs of a particular electronic debit transaction is the *only* cost the Board was expressly authorized to consider in its interchange transaction fee standard." JA66 & n.38.

This clear statutory directive is further reinforced by Congress's description of those "other costs" that must be excluded from consideration under Section 920(a)(4)(B)(ii). Congress's use of the non-restrictive pronoun "which" in describing this category of "other costs"—"other costs incurred by an issuer which are not specific to a particular electronic debit transaction"—reinforces the District Court's conclusion that the excludable costs were intended by Congress to encompass all remaining costs. JA66. *See also United States v. Indoor Cultivation Equip. From High Tech Indoor Garden Supply*, 55 F.3d 1311, 1315 (7th Cir. 1995) ("Congress's use of the pronoun 'which' is significant; it introduces a non-restrictive clause . . . that does not limit the meaning of the word it modifies."); *accord* William Strunk Jr. & E.B. White, *The Elements of Style* 59 (3d ed. 1979) ("*That* is the defining, or restrictive pronoun, which the non-defining, or non-restrictive."). Thus, "which are not specific to a particular electronic debit transaction" merely describes what Congress understood to be the remaining universe of excludable costs. JA66.

The Board complains that this reading of the "which" clause is incorrect, since Congress did not set off the non-restrictive clause in Section 920(a)(4)(B)(ii) with a comma. It argues that the absence of this comma gives rise to an ambiguity that permits the Board to fill the gap. But as the District Court correctly concluded, "[p]unctuation is a minor, and not a controlling, element in interpretation . . . ." JA67 (quoting *Barrett v. Van Pelt*, 268 U.S. 86, 91 (1925)). In addressing similar questions of statutory construction, the Supreme Court has

refused "to attach significance to an omitted comma." *United States v. Bass*, 404 U.S. 336, 340 n.6 (1971).[5]

2. Traditional Tools of Statutory Interpretation Foreclose the Board's Interpretation

The merchants' argument does not hinge on the meaning of a missing comma, however, since the District Court's discussion of grammar merely reinforces what other traditional tools of statutory construction make clear. By claiming discretion to include in the fee standard any cost not explicitly *excluded* by Section 920(a)(4)(B)(ii), the Board effectively fails to give meaning to several critical limiting characteristics of *includable* costs in Section 920(a)(4)(B). Congress did not describe with specificity the characteristics of includable costs for the Board to simply ignore these limiting characteristics in determining which costs to allow.

Yet this is precisely the interpretation that the Board embraced, concluding that it has the authority to include not only "incremental" costs but also non-incremental (*i.e*., fixed) costs. As long as it includes both, reasons the Board, it need not address the meaning of the limiting language in Section 920(a)(4)(B)(i) at all. JA427 ("The Board does not find it necessary to determine whether costs are 'incremental,' fixed or variable, or incurred in connection with authorization,

---

[5] *Barnhart v. Thomas*, 540 U.S. 20, 24 (2003), cited by the Board in support of its argument that the statutory pronoun "which" is restrictive, contained no such holding since the statutory meaning of the phrase was not disputed there.

clearance or settlement.”). In the Board’s view, it *complies* with the statutory mandate by *disregarding* the statute’s plain limiting language.

This is an absurd construction. Congress would not delineate with specificity the characteristics of includable costs (*e.g.*, incremental) if it intended, by its silence, to allow the Board to consider and include *their opposite* (*e.g.*, non-incremental). *See American Petroleum Institute v. EPA*, 198 F.3d 275, 278 (D.C. Cir. 2000) (“if Congress makes an explicit provision for apples, oranges and bananas, it is most unlikely to have meant grapefruit”). This Court has “repeatedly rejected the notion that the absence of an express proscription allows an agency to ignore a proscription implied by the limiting language of a statute.” *Southern Cal. Edison*, 195 F.3d at 24; *see Halverson v. Slater*, 129 F.3d 180, 187 (D.C. Cir. 1997). In *Southern California Edison*, the absence of statutory language explicitly stating that certain limited secondary fossil fuel uses permitted by statute were intended to be exclusive was not enough to grant the FERC discretion to create a “new category of nonconforming uses fueled by such sources that is nowhere mentioned in [the statute] . . . .” *Id.* at 24. So too here. The “limiting language” in Section 920(a)(4)(B) “loses virtually all meaning if it delegates to [the Board] the authority to expand” by silence the class of includable costs to include in its standard even those costs that *fail to satisfy* those limitations. *See id.*

Congress need not explicitly state that it is withholding the authority to create a new category of includable costs when that conclusion is apparent from the structure of the statute. *See id*. Statutory “[a]mbiguity is a creature not of definitional possibilities, but of context.” *Brown v. Gardner*, 513 U.S. 115, 118

(1994); *ABA*, 430 F.3d at 469. The Board's approach, which demands rote judicial deference from the mere theoretical possibility that Congress did not explicitly exclude a third category of costs, "requires 'tortured statutory interpretation,' and is based on the unlikely circumstance as to congressional intent giving agencies 'virtually limitless hegemony,' a result plainly out of keeping with *Chevron.*" *Southern Cal. Edison*, 195 F.3d at 24 (citation omitted); *see also Ry. Labor Execs. Ass'n v. National Mediation Bd.*, 29 F.3d 655, 671 (D.C. Cir. 1994) (agencies cannot "presume a delegation of power absent an express withholding of such power"); *Ethyl Corp. v. EPA*, 51 F.3d 1053, 1060 (D.C. Cir. 1995).[6]

The Board's interpretation is also inconsistent with the legislative history of the Durbin Amendment.[7] Senator Durbin, the Amendment's chief Senate sponsor, explained on the floor of Senate:

---

[6] The Board notes that this Court is reluctant to infer that Congress has precluded an agency from considering additional factors beyond those enumerated in a statute. Appellant Br. 56-57. Here, the Board is not merely considering additional costs, but costs that directly contradict those that Congress intended to be included in the fee standard.

[7] If "the legislative history of the enactment shows with sufficient clarity that the agency construction is contrary to the will of Congress," then *Chevron* deference is inappropriate. *Japan Whaling Ass'n v. Am. Cetacean Soc'y*, 478 U.S. 221, 233-34 (1986); *see also Natural Res. Def. Council v. Browner*, 57 F.3d 1122 1127 (D.C. Cir. 1995) ("legislative history may often shed new light on congressional intent, notwithstanding statutory language that appears 'superficially clear.'"); *Catawba County, N.C. v. EPA*, 571 F.3d 20, 35 (D.C. Cir. 2009) ("a statute may foreclose an agency's preferred interpretation despite such textual ambiguities if its structure, legislative history or purpose makes clear what its text leaves opaque").

> 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. S5,925 (daily ed. July 15, 2010) (statement of Sen. Richard J. Durbin) (emphasis added); *see also* JA435.

The Board acknowledges this floor statement bifurcates costs into those "incremental" ACS costs that must be included in the standard and all "other costs" that must be excluded. *See* Appellant Br. 58-59. It argues, however, that the statement be disregarded because it represents merely the views of one legislator. While not controlling, a sponsor's floor statements provide some indicia of legislative meaning, especially where they merely *confirm* a statute's plain meaning. *See, e.g.*, *Blair-Bey v. Quick*, 151 F.3d 1036, 1040 (D.C. Cir. 1998) (examining floor statements of bill's Senate sponsors). This is particularly true where, as here, the floor debate is the *only* legislative history, since the Durbin Amendment was a floor amendment that did not go through committee in either House. Senator Durbin's explanation of his Amendment is "persuasive evidence of congressional intent" in light of the "key role" he played in enacting the provision.[8] That legislative history confirms that Congress did not intend, through

---

[8] *Begier v. IRS*, 496 U.S. 53, 64 & n.5 (1990); *see also N. Haven Bd. of Educ. v. Bell*, 456 U.S. 512, 527 (1982) (remarks by "sponsor of the language (Continued …)

its purported silence, to create a "third category" of costs which the Board may include at its discretion.[9]

3. The Board's Interpretation of the Excludable Cost Provision Contravenes Its Plain Language

A close examination of how the Board conjured its third category of costs confirms that the Final Rule conflicts with the statute's plain terms. The Board did so only by improperly narrowing those costs explicitly excluded by Section 920(a)(4)(B)(ii), in direct conflict with the plain language of the statute. *See* JA75.[10] The Board's interpretation disregards the "basic difference between filling

---

enacted . . . are an authoritative guide to the statute's construction" where legislation arose as a floor amendment and "no committee report discusses the provision"); *Kimberlin v. U.S. Dep't of Justice*, 318 F.3d 228, 232 (D.C. Cir. 2003) ("absent other legislative history, 'we must look to the statements of the sponsors of the bill as 'the only authoritative indication of congressional intent'").

[9] The Board argues that Congress would have expressed itself more directly if it meant to bifurcate transactions costs into includable cost and all other costs. The question is not whether Congress could have used different language, but whether the language it did use clearly forecloses the Board's interpretation, and it does. *See* JA40 & n.36.

[10] The District Court also correctly reasoned that the Board's interpretation conflicted with related provisions of Section 920. First, the Board improperly read the statute's directive that it consider the "functional similarity" between debit transactions and "checking transactions that are required . . . to clear at par," to *expand* the scope of costs that it could consider in the fee standard. It did so by incorrectly reading "functional similarity" to permit it to consider "functional differences," transforming a provision intended to put downward pressure on costs (*see* 156 Cong. Rec. S3,695 (daily ed. May 13, 2010)) into an upward ratchet on allowable costs. *See* JA34-36. Second, the court supported its reading of Section 920 with the statute's reporting provision, which requires the Board to (Continued …)

a gap left by Congress' silence and rewriting rules that Congress has affirmatively and specifically enacted." *United States v. Locke*, 471 U.S. 84, 95 (1985) (quoting *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 625 (1978)).

Adopting a reading rejected in the NPRM, JA112, the Final Rule interpreted excludable "other costs . . . not *specific* to a *particular* electronic debit transaction" in 15 U.S.C. § 1693o-2(a)(4)(B)(ii) (emphasis added), to mean "those costs that are not incurred in the course of effecting *any* electronic debit transaction." JA172 (emphasis added). Under the Board's view, it does not matter whether costs are variable costs attributable to a "particular" transaction or fixed costs common to all transactions. Costs are "specific" to "each and every electronic debit transaction" where "no electronic debit transaction can occur without incurring these costs." JA173; *see also* Appellant Br. 42. That is, as long as "costs were specific to effecting debit card transactions *as a whole*," they are not excluded from consideration under the Board's interpretation of Section 920(a)(4)(B)(ii). JA172 (emphasis added). The Board therefore found discretion to consider a range of costs—such as fixed costs of equipment, hardware and software—that are incurred regardless of whether a *particular* transaction occurs.

---

publicly report information concerning "costs incurred . . . in connection with the authorization, clearance or settlement" of electronic debit transactions, 15 U.S.C. § 1693o-2(a)(3)(B), tracking in significant respect the ACS costs deemed allowable by Congress. JA34.

A more countertextual statutory reading is difficult to imagine. *See Nuclear Energy Inst., Inc. v. EPA*, 373 F.3d 1251, 1272 (D.C. Cir. 2004) ("Only in a world where 'based upon' means 'in disregard of' and 'consistent with' means 'inconsistent with'" could the agency's implementation of statute be considered permissible); *Daley*, 209 F.3d at 754. The terms "specific" and "particular" clearly foreclose the Board's interpretation. A cost is "specific" if it is "limiting or limited; specifying or specified; precise; definite; explicit." *Webster's New College Dictionary* 1376 (2007). "[P]articular" means "[o]f or belonging to a single, definite person, part, group or thing, not general; distinct." *Id.* at 1050; *see also Black's Law Dictionary* 1119 (6th ed. 1990) ("relating to a part or portion of anything; separate; sole; single; individual; specific; local; comprising a part only; partial in extent; not universal"). Read together, a cost is "specific" to a "particular" debit transaction where it is incurred in connection with a *distinct* transaction, not in common with *all* transactions. *See* JA76. The Board deprives one or both of these limiting terms of meaning.

The Board concedes that when Congress wanted to address costs relevant to transactions "as a whole," it used different language. *See* Appellant Br. 65-66. In discussing the statute's separate fraud prevention adjustment in Section 920(a)(5)(A)(i)—which permits an adjustment for fraud prevention costs incurred "in relation to electronic debit transactions involving that issuer," 15 U.S.C. § 1693o-2(a)(5)(A)(ii), the Board notes that this distinct statutory language authorizes recovery of fraud prevention costs "in relation to electronic debit transactions as a whole." Appellant Br. 65. Specifically contrasting

Section 920(a)(4)(B)—the Board reasons that "Congress's elimination of the word 'particular' and its use of the more general phrase 'in relation to,' along with its use of the plural 'transactions,' indicates that it intended the Board's fraud-prevention adjustment to take into account an issuer's fraud prevention costs *over a broad spectrum of transactions that are not linked to a particular transaction*." *Id.* at 66 (emphasis added). Despite the apparent contradiction, the Board claims precisely the same authority to consider costs relating to "electronic debit transactions as a whole" under Section 920(a)(4)(B), where Congress *did* limit the Board's authority to considering costs of a "particular" transaction.

Through artificially *narrowing* excludable costs, the Board finds authority to *expand* allowable costs beyond those defined by Congress. But the statute simply is *not* silent or ambiguous—there is no phantom third category of costs under its plain terms. *See Engine Mfrs. Ass'n v. EPA*, 88 F.3d 1075, 1088 (D.C. Cir. 1996) (where statute "clearly requires a particular outcome, then the mere fact that it does so implicitly rather than expressly does not mean that it is 'silent' in the *Chevron* sense"). Read in proper context, the "other costs" excluded from consideration under Section (a)(4)(B)(ii) covers *all* "other costs" not explicitly addressed in Section (a)(4)(B)(i). *See Riverkeeper*, 556 U.S. at 223 (noting the "unremarkable

proposition that sometimes statutory silence, when viewed in context, is best interpreted as limiting agency discretion”).[11]

The Board complains that a literal statutory interpretation “would appear to exclude almost all costs related to electronic debit transactions because very few costs could be specifically assigned to a given transaction.” JA172. But the Board’s own NPRM contradicts this assertion. It would have authorized banks to recover as much as 12 cents per transaction—yielding billions of dollars in allowable costs. In any event, it is not the Board’s province “to attempt to soften the clear import of Congress’ chosen words” even when it believes “those words lead to a harsh result.” *Locke*, 471 U.S. at 95.

4. The Particular Items of Costs Considered by the Board Are Foreclosed from Consideration by the Durbin Amendment

Finally, the District Court correctly grounded its decision in the fact that the Board permitted recovery of a number of particular costs items plainly precluded by the statute’s text and structure. *See* JA41-45.

Fixed Costs. Notwithstanding Section 920(a)(4)(B)’s limitation of allowable costs to the “incremental” ACS costs of a particular transaction,

---

[11] The Board cites *Riverkeeper* for the opposite proposition. There, the Court found delegation by statutory silence *only* because the statute was silent as “to all potentially relevant factors” that EPA could consider. Because implementing the statute without considering any relevant factors was a “logical impossibility,” the Court concluded that silence suggested that Congress meant to delegate authority. *Id.* at 222.

15 U.S.C. § 1693o-2(a)(4)(B), the Board determined that it had the authority to include fixed costs as well. Appellant Br. 63-64; JA175. It vastly expanded allowable costs to include *any* ACS costs, such as network hardware and software costs, that do not vary with a particular transaction.

Reasoning that it was not required even to define "incremental costs" under Section 920(a)(4)(B)(i), the Board argues that it has satisfied its statutory obligations and *necessarily* considered "incremental" ACS costs by considering *all* ACS costs. Appellant Br. 42. At the same time, it argues that the statute's failure to define the "incremental" leaves its interpretation to the Board's discretion. *Id.* at 54. But "[i]f an agency fails or refuses to deploy [its] expertise—for example, by simply picking a permissible interpretation out of a hat—it deserves no deference." *Vill. Of Barrington, Ill. v. Surface Transp. Bd*, 635 F.3d 650, 660 (D.C. Cir. 2011); *see also Qwest Corp. v. FCC*, 258 F.3d 1191, 1202 (10th Cir. 2001) (court need not credit agency interpretation that "fail[s] to define [statutory] terms at all").

The Board's allowance for fixed costs is at odds with the plain language of Section 920(a)(4)(B)(ii). By definition, fixed costs are not "specific" to any "particular" transaction and fall squarely within the statute's excludable costs provision, Section 920(a)(4)(B)(ii). *See* JA112 ("Such fixed costs of production could not be avoided by ceasing production of any particular transaction (except perhaps the first."); *San Antonio, Tx. Acting By & Through Its City Pub. Serv. Bd. v. United States*, 631 F.2d 831, 851 n.11 (D.C. Cir. 1980) ("By definition, fixed costs are not associated with any particular traffic.").

By contrast, Congress's allowance for "incremental" costs requires that the Board consider only the "additional or increased costs" associated with a particular transaction. *See Black's Law Dictionary* at 767 (6th ed. 1990). The NPRM properly proposed to define "incremental costs" as the average variable cost of a transaction. JA111. Numerous courts, including this one, have similarly equated "incremental costs" with "variable costs." *See* JA32 ("The term 'incremental' limits the includable costs to 'variable, as opposed to fixed,' ACS costs.") (citing *Me Pub. Serv. Co. v. FERC*, 964 F.2d 5, 9 (D.C. Cir. 1992); *see also Cascade Health Solutions v. Peacehealth*, 515 F.3d 883, 910 (9th Cir. 2008); *Morgan v. Ponder*, 892 F.2d 1355, 1362 n.17 (8th Cir. 1989).

Transactions monitoring. The Board also included in its interchange fee standard an allowance for "transactions monitoring costs." JA176. Transaction monitoring involves pre-transaction measures to prevent fraudulent transactions, such as neural networks to detect suspicious activity. JA176-77. According to the Board, transactions monitoring was the most commonly reported bank fraud prevention activity. JA143.

The inclusion of transactions monitoring costs as allowable costs is directly contradicted by the statute. Rather than allowing those fraud prevention costs in the interchange fee standard, Congress explicitly directs the Board to permit a *separate* "adjustment to the fee amount received or charged by an issuer . . . to make allowance for costs incurred by the issuer in preventing fraud." 15 U.S.C. § 1693o-2(a)(5)(A)(i). An issuer is allowed to recover this additional amount—currently 1 cent per transaction, *see* 77 Fed. Reg. 46,258—only where it "complies

with fraud-related standards established by the Board" to reduce fraud. 15 U.S.C. § 1693o-2(a)(5)(A)(ii). The Board's inclusion of transactions monitoring costs in the basic interchange fee standard circumvents this statutory condition and frustrates Congress's purpose in ensuring that issuers adopt "effective steps to reduce the occurrence of, and costs from fraud." *Id.* § 1693o-2(a)(5)(A)(ii)(II). *See Hearth, Patio & Barbecue Ass'n v. U.S. Dep't of Energy*, 706 F.3d 499, 506 (D.C. Cir. 2013) (agency was "free to grow its regulatory authority through the statutorily provided for means, but chose instead to push the outermost limits of interpretive credulity").

The Board argues that Section 920(a)(5)(A) permits this adjustment "for issuer costs of preventing fraud in relation to electronic debit transactions as a whole, and not in relation to a particular electronic debit transaction." Appellant Br. 65-66; JA177. But there is no support for that distinction. It is preposterous to suggest that Congress would *specifically address* the costs associated with fraud prevention in a separate provision of the statute, condition the recovery of those costs on an issuer's compliance with fraud prevention measures, and then, by virtue of contrived statutory "silence," permit recovery of those very same costs in Section 920(a)(4)(B). *See Whitman v. American Trucking Ass'ns*, 531 U.S. 457, 467 (2001) (refusing to "find implicit in ambiguous sections of [a statute] an authorization to consider costs that has elsewhere, and so often, been expressly granted"); *see also Halverson*, 129 F.3d at 187; JA43.

Senator Durbin's explanation of the fraud prevention adjustment again refutes the Board's interpretation, confirming that transactions monitoring is not

includable in the basic interchange fee standard. Senator Durbin noted in floor debates 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 incremental issuer costs upon which the reasonable and proportional fee is based." 156 Cong. Rec. S5,925 (daily ed. July 15, 2010) (emphasis added); *see also* JA438.

Fraud losses. Section 920(a)(5)(A) also plainly bars the consideration of fraud *losses* in the interchange fee. That provision directs that "*any* fraud-related adjustment of the issuer" under the statute "is limited to the amount described in clause (i)[,the "allowance for costs incurred by the issuer *in preventing fraud*']." 15 U.S.C. § 1693o-2(a)(5)(B) (emphasis added). The Board recognized this limitation in its proposed rule, concluding that fraud losses "are not includable as allowable costs." JA136; *see also* JA118 n.79. The Final Rule reversed course, allowing fraud loss recovery through a 5-basis-point *ad valorem* charge because they are "generally the result of an issuer's authorization, clearance and settlement of a particular electronic debit transaction," and includable under the expanded interpretation of allowable costs. JA177; Appellant Br. 67.

The Board's fraud-loss allowance ignores the plain language of the statute. As the District Court explained, "the costs associated with the *consequence* of ACS—as opposed to ACS costs themselves—are not to be considered under the plain language of the statute." JA80. Indeed, the Board concedes in its brief that fraud losses are not an "'incremental cost' incurred by the issuer *for its role* in ACS." Appellant Br. 53. Moreover, Congress would not have taken care to limit

"any fraud-related adjustment of the issuer," 15 U.S.C. § 1693o-2(a)(5)(A)(ii)(I), to fraud-prevention costs if it intended silently to allow the inclusion of any *other* fraud-related costs, such as fraud losses, elsewhere in the interchange fee standard.

An allowance for fraud losses would also frustrate Congress's purpose of requiring banks to satisfy anti-fraud standards before collecting a fraud prevention adjustment. Congress directed the Board, in setting anti-fraud standards, to consider "the extent to which interchange transaction fees have in the past reduced or increased incentives for parties involved in electronic debit transactions to reduce fraud on such transactions." *Id.* § 1693o-2(a)(5)(B)(ii)(V), (VI). The Board nonetheless permits banks to use the same interchange fee to recover a part of their fraud losses, irrespective of any particular bank's efforts to reduce fraud. Thus, the Board's *own fee standard* frustrates Congress's goal of incenting fraud reduction. The Board sought to deflect this criticism, asserting that the inclusion of fraud losses in the interchange fee standard will not eliminate an issuer's incentives to reduce fraud losses. *See* JA177. But permitting a bank to recover fraud losses certainly *reduces* those incentives, which Congress plainly sought to prevent in Section 920(a)(5)(B).[12]

---

[12] The Final Rule also improperly permitted recovery of the issuing bank's network fees. *See* JA45. The Board acknowledged that these "network fees typically are not associated with one specific component of authorization, clearance, or settlement of the transaction." JA111. Nor do network fees compensate the issuer for "its role" in processing the transaction, as required by Section 920(a)(4)(B). *See* JA142 (network fees "compensate *the network* for *its*

(Continued …)

B. The Board's Interpretation Is Unreasonable

Because the Board's interchange fee standard is foreclosed by the plain language of the Durbin Amendment, this case should be decided under *Chevron*'s first step. But even if this Court were to determine that the statute is ambiguous with respect to the Board's interpretation, the Final Rule would still fail under *Chevron*'s second step, because its interpretation is not "reasonable and consistent with the statutory scheme and legislative history." *City of Cleveland, Ohio v. U.S. Nuclear Regulatory Comm'n*, 68 F.3d 1361, 1367 (D.C. Cir. 1995). While deferential, this review "is neither rote nor meaningless[.]" *Daley*, 209 F.3d at 752.

Many of the same arguments discussed above also demonstrate the unreasonableness of the interchange fee standard. The Board's mere invocation of statutory silence does not grant it the authority to adopt an interpretation at odds with the statute's plain language, purpose and legislative history.

At bottom, the Board has failed in its assigned task. Congress adopted the Durbin Amendment to contain runaway debit interchange costs, which had proved crippling to many retailers. Yet "[b]y including in the interchange fee standard

---

role in processing the transaction"); *see also* Appellant Br. 5. Moreover, the statute's limitation of the Board's authority over network fees to those regulations necessary to ensure that network fees are "not used to directly or indirectly compensate an issuer with respect to an electronic debit transaction," 15 U.S.C. § 1693o-2(a)(8), strongly suggests that Congress did not intend recovery of network fees to compensate an issuer as part of the interchange fee.

costs that are expressly prohibited by the statute, the final regulation represents a significant price *increase* over pre-Durbin rates" for many transactions and retailers affected by the Final Rule. JA82 (citing 7-Eleven *Amicus* Br. 17-18). Congress did "not empower the Board to make policy judgments that would result in significantly *higher* interchange rates." *Id.* And even as to those transactions where the Final rule lowered prevailing market rates, the statute did not empower the Board to disregard its plain language and purpose to permit recovery of a wide range of costs not permitted by Congress. The Final Rule's interpretation of the interchange fee standard "diverges from any realistic meaning of the statute," and must be invalidated. *Massachusetts v. U.S. Dep't of Transp.*, 93 F.3d 890, 893 (D.C. Cir. 1996).

III. The Final Rule's Implementation of the Durbin Amendment's Network Non-Exclusivity Provision Violates the APA

A. The Board's Non-Exclusivity Regulation Fails *Chevron*'s First Step

1. The Final Rule Contravenes the Plain Language of the Statute

The District Court also correctly held that the Final Rule's non-exclusivity provision, 12 C.F.R. § 235.7(a), contravenes the letter and purpose of the Durbin Amendment. By its plain terms, the statute requires the Board to ensure that merchants be afforded a choice of networks for *each debit transaction*. JA83-84. It directs the Board to "prescribe regulations providing that an issuer or payment card network shall not directly or through any agent . . . by contract, requirement or otherwise, restrict the number of payment card networks on which *an electronic*

debit transaction may be processed" to less than two unaffiliated networks. 15 U.S.C. § 1693o-2(b)(1)(A) (emphasis added). As the Board notes, Appellant Br. 19-20, the statute's purpose is to preserve and enhance network competition and choice. JA442.

In its Final Rule, the Board failed to ensure competitive choice for a sizeable segment of debit transactions. The Final Rule directed only each "debit card subject to the regulation to be enabled on at least two unaffiliated payment card networks." Official Cmt. 1 to Section 235.7(a). The Rule permits issuers and networks to comply by providing one signature network and one unaffiliated PIN network *per card*. *Id*; *see also* JA220. But as the District Court concluded, "Congress's focus was on the number of networks over which each *transaction*—as opposed to each debit card—can be processed." JA84.

The Board acknowledged its rule "provides merchants fewer routing options with respect to certain electronic debit transactions" when compared to its proposed alternative, which would have guaranteed multiple routing options for each method of authentication. JA194. Indeed, it found that large classes of transactions in the marketplace (*e.g.*, internet and mail order transactions) cannot be processed over PIN networks, and the vast majority of merchants that accept debit cards are not configured to accept PIN-debit transactions. JA141. Yet the Final Rule provides no merchant choice in any of these circumstances.

2. The Final Rule Permits Networks to Maintain Rules and Practices that Inhibit Merchant Competitive Choice

Far from ensuring compliance with the Durbin Amendment, the Rule *guarantees* that merchants will be deprived of network choice for a substantial segment of debit transactions in the marketplace today. The problem stems from prevailing network rules and practices. *See Associated General Contractors, Inc. v. California State Council of Carpenters*, 459 U.S. 519, 530 (1983) (statutory interpretation cannot "ignore the larger context in which the entire statute was debated"). Owing to the separate evolution of the networks, the two predominant authentication methods available for processing debit transactions—PIN and signature—route over different networks using differing infrastructure. JA141. Where a merchant can process both signature and PIN transactions, the customer generally determines the authentication method at the point of sale, by choosing "debit" for PIN authentication or "credit" for signature authentication. JA194.

Where the customer chooses a particular method of authentication, the statute unambiguously requires that the issuer or network not restrict the merchant's routing choices for that transaction to a single network. Yet this single-network routing is precisely what the Board allows. An issuer complies by enabling its card to work on one signature debit network and one unaffiliated PIN-debit network. If a customer elects signature authentication at the point of sale, the regulation deprives the merchant of the *transactional* routing choice guaranteed by the Durbin Amendment, permitting the issuer to provide only a single signature

network on which that "electronic debit transaction may be processed." 15 U.S.C. § 1693o-2(b)(1)(A).

Similarly, in many circumstances, one of the two methods of debit transaction authentication is simply not available. The Board acknowledges that only one in four merchants is enabled for PIN authentication. JA125, JA141. For many categories of transactions, too, PIN-network routing is generally not available. These include internet, mail order or telephone transactions (where customers are generally reluctant to provide their PIN), and hotel stays, rental cars or restaurant transactions ("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"). *See* JA125, JA141. The Final Rule fails to clear away issuer- and network-imposed restrictions that limit choice to a single network and deprive merchants of the requisite competitive network choice with respect to each of these transactions. JA52.

The Board rationalizes away this problem, reasoning that, where the consumer has elected one method of authentication over another, it is "the consumer, and not the issuer or the payment card network, [that] has restricted the available routing choices." JA194; Appellant Br. 22. It similarly faults merchants for failing to invest the significant resources in the point-of-sale infrastructure

needed to accept PIN transactions,[13] and blames those businesses in parts of the retail industry that are not adaptable to signature-transaction technology for the Board's own failure. JA194. Because the statute only precludes "issuers" and "networks" from restricting routing choices, the Board asserts that it has complied with its statutory obligations. Appellant Br. 22.

The District Court properly rejected the Board's efforts to rationalize its circumvention of the statute's "transaction"-specific guarantee, holding that "it is *issuers* and *networks* who establish the availability of different routing options, well before consumers ever enter the picture." JA88 (emphasis added). Indeed, Visa and MasterCard have long maintained exclusivity rules that prevent banks from putting competing signature networks on their cards. JA306 (Salop, ¶ 30 & n.17), JA552. As explained in comments to the Board, those same networks maintain rules that prohibit cross-routing, preventing PIN networks from processing signature transactions, and vice versa. *See* JA54 n.42, 552, 555-56 & n.2; *see also* Adam J. Levitin, *Cross Routing: PIN and Signature Debit Interchangeability Under the Durbin Amendment,* 2 LYDIAN J 16 (Dec. 2010) ("Currently, debit cross-routing is not permitted by networks.").[14]

---

[13] To receive the benefit of the non-exclusivity rule, plaintiff Boscov's would have to invest $700,000 to retrofit its stores with PIN-processing technology. ECF No. 26-6, Ex. E (Declaration of Dean Shaeffer, ¶ 8.)

[14] The Board acknowledged these restrictions, noting that under the one-network-per-authentication-method rule, "once the cardholder has authorized the

(Continued …)

The Final Rule allows Visa and MasterCard to maintain this artificial routing wall between signature and PIN networks. There is no reason, then, *apart from prevailing network rules*, that a PIN network unaffiliated with Visa or MasterCard could not process signature transactions and provide network choice for the merchant at the point of sale.[15] It is therefore *network* "requirements" that "restrict the number of payment card networks on which an electronic debit transaction may be processed,' 15 U.S.C. § 1693o-2(B)(1)(A), and prevent the merchant from realizing the benefits of a competitive network choice in these transactions. But the Board "cannot be relieved of its statutory obligation to ensure that network and issuer practices do not inhibit merchant choice simply because, in many transactions, consumers choose the authentication method." JA88; *see Chevron*,

---

transaction using either a signature or PIN entry, the merchant would have only a single network available for routing the transaction." JA125-26.

[15] Oddly, the Board cites Professor Levitin for the proposition that even supporters of multiple routing options for each authentication method "recognize that merchants could use PIN authorization in 'virtually every setting." Appellant Br. 25. Its quotation is seriously misleading. Professor Levitin observed that, "[w]hile the use of PIN debit is *theoretically possible* in virtually every setting, Senator Durbin's floor statement is clearly directed toward the actual state of the world, where PIN debit is not used by many types of merchants." 2 Lydian J. 16, n.15 (emphasis added) (available at http://www.federalreserve.gov/newsevents/files/levitin_paper_20101124.pdf). Levitin's point was that the *technology* exists to permit cross-routing, but current network rules and practices stand in the way.

467 U.S. at 865-66 (agency's implementation of Congressional policy must account for "everyday realities").[16]

For similar reasons, the District Court correctly reasoned that the network non-exclusivity rules effectively deprive of any meaning the companion "routing restriction" provision for a large number of debit transactions and for the majority of merchants. Section 920(B)(1)(B) requires the Board to ensure that networks and issuing banks do not "inhibit the ability of a person who accepts debit cards for payments to direct the routing of electronic debit cards for processing over any payment card network that may process such transactions." 15 U.S.C. § 1693o-2(B)(1)(B). The Board acknowledged in its NPRM that the one-network-per-authentication-method rule that it eventually chose "could limit the effectiveness of the separate prohibition on merchant routing restrictions." JA125. The District Court agreed, reasoning that the routing provision "makes sense only if merchants have a *choice* between multiple networks." JA54. It "would defy all logic for Congress to safeguard the merchant's ability to route transactions over the

---

[16] The Board posits that merchants could render issuers non-complaint with the statute by "fail[ing] to contract with sufficient payment card networks to ensure routing choice for a particular transaction." Appellant Br. 26. But merchants do not contract with payment card networks; they contract with processors or acquiring banks that connect with all of the national payment card networks.

networks of their choosing while at the same time leaving it up to the Board to decide whether issuers give merchants any choice in the first place." *Id.*[17]

The Board complains that the Merchants' statutory interpretation would require "an inviolate guarantee that multiple payment card networks be available to merchants in all instances and for all methods of authenticating a transaction." Appellant Br. 21; *see also* JA193. But the Board mischaracterizes the Merchants' position. Merchants do not contend that the statute requires multiple unaffiliated networks for each method of authentication on each debit card, because the statute does not set any requirements whatsoever for *debit cards*. Instead, it requires two unaffiliated networks for each *transaction*. 15 U.S.C. § 1693o-2(b)(1)(A). While the Board *could* ensure compliance with this provision by requiring multiple unaffiliated networks for each method of authentication, it might choose to do so through equally viable non-card based alternatives, such as taking down the prevailing, artificial wall between signature and PIN networks so that every network can process either type of transaction. JA552. What the Board cannot do

[17] The Board argues that its Final Rule complies with Section 920(b)(1)(B) because, in those circumstances in which a card happens to be configured with multiple PIN networks (beyond what is required by the rule), networks and issuers can no longer direct routing priorities among enabled networks. Appellant Br. 30. While this is undoubtedly true, it is also beside the point, as it fails to account for the large number of cards that will not be configured with multiple PIN networks as a result of the rule allowing single signature and PIN networks. Nor does it account for the fact that the rule permits networks and issuing banks to comply by providing no routing choices whatsoever for signature transactions.

is what it did here, since the Final Rule fails to assure the competitive network choice that the Durbin Amendment requires.

3. The Statute's Legislative History Confirms that Merchants Must Be Given a Choice of Network for Each Transaction

The legislative history of the Durbin Amendment reinforces the District Court's ruling. The non-exclusivity provision was the result of a House-Senate compromise that sought to control network costs through enhanced market competition. *See* H.R. Conf. Rep. No. 111-517, at 704-11 (2010). The compromise alleviated the need for the Board to delve into individual cost items at the network level, as the Senate version of the bill had required. Instead, the Board was required simply to ensure that each and every transaction—no matter the method of authentication—could be processed over at least two competing networks and that merchants would have the unimpeded ability to choose between the available networks. *See* 156 Cong. Rec. S3,704 (daily ed. May 13, 2010) (statement of Sen. Richard J. Durbin) (statute is designed so that "merchant may decide to favor one network over another").

As Senator Durbin confirmed in explaining the final bill, Section 920(b)(1) "is intended to enable each and every 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." 156 Cong. Rec. S5,926 (daily ed. July 15, 2010) (statement of Sen. Richard J. Durbin) (emphasis added). Thus, "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." *Id.* Not allowing PIN networks to carry signature transactions (and vice versa) makes those networks "limited" in the manner that Senator Durbin warned was insufficient to comply with the statute.

The Board criticizes the District Court's reliance on this clear statement of legislative purpose, again arguing that one Senator's views are insufficient to vary the plain meaning of the statute. Appellant Br. 31-33. But the District Court merely read the legislative history—which, like the statute, focuses on "each and every electronic debit transaction"—to *confirm* its reading of the statute's plain language. JA86-87. This is precisely the role *Chevron* contemplates for legislative history. 467 U.S. at 851-53, 862-64; *see* discussion, *supra*, Section II(A)(2). In ignoring the plain statutory text, as explained by its Senate sponsor in equally plain terms, the Board's final rule runs afoul of *Chevron*'s first step. The District Court's ruling invalidating the non-exclusivity regulation should be affirmed.[18]

---

[18] The Board faults the District Court's reliance on the statute's definitional provisions to support its rejection of the Board's non-exclusivity rule. The statute's definition of "debit card" provides that a card falls within its provisions whether authorization is based on signature or PIN. 15 U.S.C. § 1693o-2(c)(2)(A). The District Court read that definition to suggest that the statute's transaction-specific non-discrimination provision applied regardless of the method of authorization used by the cardholder. JA48-49. The Court's discussion merely complements its central reasoning, based on the statute's plain focus on the individual "transaction" and this supporting legislative history.

B. The Board's Interpretation Is Unreasonable and Fails *Chevron*'s Second Step

The Board's non-exclusivity rule should be invalidated even if the Court were to reach *Chevron*'s second step. The Final Rule fails *Chevron's* deferential review because it does not implement the statute's purpose. *See GTE Serv. Corp. v. FCC*, 205 F.3d 416, 421 (D.C. Cir. 2000).

The Board acknowledges that promoting merchant choice among networks was a principal objective of the non-exclusivity requirement. JA192. Routing choice "may promote direct price competition for merchants among the debit card networks that are enabled on the debit card." *Id.* The routing restrictions targeted for elimination by Section 920(b)(1)(A) "limit merchants' ability to route transactions over lower-cost networks and may reduce network price competition." *Id.*

Despite the Board's protestations, Appellant Br. 36-38, the Final Rule fails effectively to enhance this network price competition. Indeed, the NPRM acknowledged that "the effectiveness of the rule promoting network competition could be limited in some circumstances if an issuer can satisfy the requirement simply by having one payment card network for signature debit transactions and a second unaffiliated payment card network for PIN debit transactions." JA125. Despite the breadth of those circumstances, the Board nevertheless adopted that option, while conceding that its Final Rule provides "fewer routing options" than alternative constructions. JA194.

The Board seeks to blunt this disregard for statutory purpose, noting that, under the Final Rule, "merchants that currently accept PIN debit would have routing choice with respect to PIN debit transactions in many cases where an issuer chooses to participate in multiple PIN debit networks." *Id.* But that result is not compelled by the Final Rule in any circumstance—it is merely a possible result of voluntary over-compliance. And, as the Board acknowledges, 75% of merchant locations in the United States that accept debit cards do not have the capability to accept PIN-debit transactions. JA141. Its observation is cold comfort to the vast majority of merchants affected by the Final Rule. *Id.* Where, as here, the Board's rule is not likely to implement the statute's mandate in such a large percentage of real-world circumstances, it is unreasonable. *See, e.g.*, *Daley*, 209 F.3d at 754 (measure that "is at least four times as likely to fail as to succeed" unreasonable).

CONCLUSION

For the foregoing reasons, the Court should affirm the District Court.

Respectfully submitted,

By /s/ Shannen W. Coffin

Shannen W. Coffin
Douglas S. Kantor
Linda C. Bailey
STEPTOE & JOHNSON LLP
1330 Connecticut Avenue, N.W.
Washington, D.C. 20036
(202) 429-3000
scoffin@steptoe.com
dkantor@steptoe.com
lbailey@steptoe.com

Attorneys for Plaintiffs-Appellees NACS, National Retail Federation, Food Marketing Institute, Miller Oil Co., Inc., Boscov's Department Store, LLC, and National Restaurant Association

CERTIFICATE OF COMPLIANCE

I certify that, pursuant to Federal Rule of Appellate Procedure 32(a)(7)(C) and Circuit Rule 32(a)(7)(B)(i), the foregoing Appellee Response Brief is proportionately spaced, has a typeface of 14 points or more, and contains 13,971 words.

DATED this 20th day of November, 2013.

/s/ Shannen W. Coffin
Shannen W. Coffin

CERTIFICATE OF FILING AND SERVICE

I hereby certify that on November 20, 2013, I electronically filed the foregoing with the Clerk of the Court for the U.S. Court of Appeals for the District of Columbia Circuit by using the appellate CM/ECF system in Docket 13-5270. I certify that service will be accomplished on this day electronically through the Court's CM/ECF system on the following individuals:

Joshua Paul Chadwick
Board of Governors of the
Federal Reserve System
20th and C Streets, N.W.
Washington, DC 20551
joshua.p.chadwick@frb.gov

Yvonne Facchina Mizusawa
Board of Governors of the
Federal Reserve System
20th and C Streets, N.W.
Washington, DC 20551
yvonne.f.mizusawa@frb.gov

Katherine H. Wheatley
Board of Governors of the
Federal Reserve System
20th and C Streets, N.W.
Washington, DC 20551
kit.wheatley@frb.gov

/s/ Shannen W. Coffin
Shannen W. Coffin

ADDENDUM OF STATUTES & REGULATIONS

15 U.S.C. § 1693o-2 .... A-1

12 C.F.R. Part 235 .... A-11

15 U.S.C. § 1693o-2. Reasonable fees and rules for payment card transactions

(a) Reasonable interchange transaction fees for electronic debit transactions.

(1) Regulatory authority over interchange transaction fees. The Board may prescribe regulations, pursuant to section 553 of title 5, United States Code, regarding any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction, to implement this subsection (including related definitions), and to prevent circumvention or evasion of this subsection.

(2) 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.

(3) Rulemaking required.

(A) In general. The Board shall prescribe regulations in final form not later than 9 months after the date of enactment of the Consumer Financial Protection Act of 2010 [enacted July 21, 2010], 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.

(B) Information collection. The Board may 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 and the Board, in issuing rules under subparagraph (A) and on at least a bi-annual basis thereafter, shall disclose such aggregate or summary information concerning the costs incurred, and interchange transaction fees charged or received, by issuers or payment card networks in connection with the authorization, clearance or settlement of electronic debit transactions as the Board considers appropriate and in the public interest.

(4) Considerations; consultation. In prescribing regulations under paragraph (3)(A), the Board shall—

(A) 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;

(B) 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); and

(C) consult, as appropriate, with the Comptroller of the Currency, the Board of Directors of the Federal Deposit Insurance Corporation, the Director of the Office of Thrift Supervision, the National Credit Union Administration Board, the Administrator of the Small Business Administration, and the Director of the Bureau of Consumer Financial Protection.

(5) Adjustments to interchange transaction fees for fraud prevention costs.

(A) Adjustments. The Board may allow for an adjustment to the fee amount received or charged by an issuer under paragraph (2), if—

(i) 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; and

(ii) the issuer complies with the fraud-related standards established by the Board under subparagraph (B), which standards shall—

(I) be designed to ensure that any fraud-related adjustment of the issuer is limited to the amount described in clause (i) and takes into account any fraud-related reimbursements (including amounts from charge-backs) received from consumers, merchants, or payment card networks in relation to electronic debit transactions involving the issuer; and

(II) require issuers 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.

(B) Rulemaking required.

(i) In general. The Board shall prescribe regulations in final form not later than 9 months after the date of enactment of the Consumer Financial Protection Act of 2010 [enacted July 21, 2010], to establish standards for making adjustments under this paragraph.

(ii) Factors for consideration. In issuing the standards and prescribing regulations under this paragraph, the Board shall consider—

(I) the nature, type, and occurrence of fraud in electronic debit transactions;

(II) the extent to which the occurrence of fraud depends on whether authorization in an electronic debit transaction is based on signature, PIN, or other means;

(III) the available and economical means by which fraud on electronic debit transactions may be reduced;

(IV) the fraud prevention and data security costs expended by each party involved in electronic debit transactions (including consumers, persons who accept debit cards as a form of payment, financial institutions, retailers and payment card networks);

(V) the costs of fraudulent transactions absorbed by each party involved in such transactions (including consumers, persons who accept debit cards as a form of payment, financial institutions, retailers and payment card networks);

(VI) the extent to which interchange transaction fees have in the past reduced or increased incentives for parties involved in electronic debit transactions to reduce fraud on such transactions; and

(VII) such other factors as the Board considers appropriate.

(6) Exemption for small issuers.

(A) In general. This subsection shall not apply to any issuer that, together with its affiliates, has assets of less than $ 10,000,000,000, and the Board shall exempt such issuers from regulations prescribed under paragraph (3)(A).

(B) Definition. For purposes of this paragraph, the term "issuer" shall be limited to the person holding the asset account that is debited through an electronic debit transaction.

(7) Exemption for government-administered payment programs and reloadable prepaid cards.

(A) In general. This subsection shall not apply to an interchange transaction fee charged or received with respect to an electronic debit transaction in which a person uses—

(i) a debit card or general-use prepaid card that has been provided to a person pursuant to a Federal, State or local government-administered payment program, in which the person may only use the debit card or general-use prepaid card to transfer or debit funds, monetary value, or other assets that have been provided pursuant to such program; or

(ii) a plastic card, payment code, or device that is—

(I) linked to funds, monetary value, or assets which are purchased or loaded on a prepaid basis;

(II) not issued or approved for use to access or debit any account held by or for the benefit of the card holder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis);

(III) redeemable at multiple, unaffiliated merchants or service providers, or automated teller machines;

(IV) used to transfer or debit funds, monetary value, or other assets; and

(V) reloadable and not marketed or labeled as a gift card or gift certificate.

(B) Exception. Notwithstanding subparagraph (A), after the end of the 1-year period beginning on the effective date provided in paragraph (9), this subsection shall apply to an interchange transaction fee charged or received with respect to an electronic debit transaction described in subparagraph (A)(i) in which a person uses a general-use prepaid card, or an electronic debit transaction described in subparagraph (A)(ii), if any of the following fees may be charged to a person with respect to the card:

(i) A fee for an overdraft, including a shortage of funds or a transaction processed for an amount exceeding the account balance.

(ii) A fee imposed by the issuer for the first withdrawal per month from an automated teller machine that is part of the issuer's designated automated teller machine network.

(C) Definition. For purposes of subparagraph (B), the term "designated automated teller machine network" means either—

(i) all automated teller machines identified in the name of the issuer; or

(ii) any network of automated teller machines identified by the issuer that provides reasonable and convenient access to the issuer's customers.

(D) Reporting. Beginning 12 months after the date of enactment of the Consumer Financial Protection Act of 2010 [enacted July 21, 2010], the Board shall annually provide a report to the Congress regarding –

(i) the prevalence of the use of general-use prepaid cards in Federal, State or local government-administered payment programs; and

(ii) the interchange transaction fees and cardholder fees charged with respect to the use of such general-use prepaid cards.

(8) Regulatory authority over network fees.

(A) In general. The Board may prescribe regulations, pursuant to section 553 of title 5, United States Code, regarding any network fee.

(B) Limitation. The authority under subparagraph (A) to prescribe regulations shall be limited to 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.

(C) Rulemaking required. The Board shall prescribe regulations in final form before the end of the 9-month period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010 [enacted July 21, 2010], to carry out the authorities provided under subparagraph (A).

(9) Effective date. This subsection shall take effect at the end of the 12-month period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010 [enacted July 21, 2010].

(b) Limitation on payment card network restrictions.

(1) Prohibitions against exclusivity arrangements.

(A) No exclusive network. The Board shall, before the end of the 1-year period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010 [enacted July 21, 2010], prescribe regulations providing that an issuer or payment card network shall not directly or through any agent, processor, or licensed member of a payment card network, by contract, requirement, condition, penalty, or otherwise, restrict the number of payment card networks on which an electronic debit transaction may be processed to—

(i) 1 such network; or

(ii) 2 or more such networks which are owned, controlled, or otherwise operated by-

(I) affiliated persons; or

(II) networks affiliated with such issuer.

(B) No routing restrictions. The Board shall, before the end of the 1-year period beginning on the date of the enactment of the Consumer Financial Protection Act of 2010 [enacted July 21, 2010], prescribe regulations providing that an issuer or payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability of any person who accepts debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions.

(2) Limitation on restrictions on offering discounts for use of a form of payment.

(A) In general. A payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability of any person to provide a discount or in-kind incentive for payment by the use of cash, checks, debit cards, or credit cards to the extent that—

(i) in the case of a discount or in-kind incentive for payment by the use of debit cards, the discount or in-kind incentive does not differentiate on the basis of the issuer or the payment card network;

(ii) in the case of a discount or in-kind incentive for payment by the use of credit cards, the discount or in-kind incentive does not differentiate on the basis of the issuer or the payment card network; and

(iii) to the extent required by Federal law and applicable State law, such discount or in-kind incentive is offered to all prospective buyers and disclosed clearly and conspicuously.

(B) Lawful discounts. For purposes of this paragraph, the network may not penalize any person for the providing of a discount that is in compliance with Federal law and applicable State law.

(3) Limitation on restrictions on setting transaction minimums or maximums.

(A) In general. A payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability—

(i) of any person to set a minimum dollar value for the acceptance by that person of credit cards, to the extent that –

(I) such minimum dollar value does not differentiate between issuers or between payment card networks; and

(II) such minimum dollar value does not exceed $ 10.00; or

(ii) of any Federal agency or institution of higher education to set a maximum dollar value for the acceptance by that Federal agency or institution of higher education of credit cards, to the extent that such maximum dollar value does not differentiate between issuers or between payment card networks.

(B) Increase in minimum dollar amount. The Board may, by regulation prescribed pursuant to section 553 of title 5, United States Code, increase the amount of the dollar value listed in subparagraph (A)(i)(II).

(4) Rule of construction[:]. No provision of this subsection shall be construed to authorize any person—

(A) to discriminate between debit cards within a payment card network on the basis of the issuer that issued the debit card; or

(B) to discriminate between credit cards within a payment card network on the basis of the issuer that issued the credit card.

(c) Definitions. For purposes of this section, the following definitions shall apply:

(1) Affiliate. The term “affiliate” means any company that controls, is controlled by, or is under common control with another company.

(2) Debit card. The term “debit card”—

(A) means any card, or other payment code or device, issued or approved for use through a payment card network to debit an asset account (regardless of the purpose for which the account is established), whether authorization is based on signature, PIN, or other means;

(B) includes a general-use prepaid card, as that term is defined in section 915(a)(2)(A) [15 USCS § 1693m(a)(2)(A)]; and

(C) does not include paper checks.

(3) Credit card. The term "credit card" has the same meaning as in section 103 of the Truth in Lending Act [15 USCS § 1602].

(4) Discount. The term "discount"—

(A) means a reduction made from the price that customers are informed is the regular price; and

(B) does not include any means of increasing the price that customers are informed is the regular price.

(5) Electronic debit transaction. The term "electronic debit transaction" means a transaction in which a person uses a debit card.

(6) Federal agency. The term "Federal agency" means—

(A) an agency (as defined in section 101 of title 31, United States Code); and

(B) a Government corporation (as defined in section 103 of title 5, United States Code).

(7) Institution of higher education. The term "institution of higher education" has the same meaning as in 101 and 102 of the Higher Education Act of 1965 (20 U.S.C. 1001, 1002).

(8) Interchange transaction fee. The term "interchange transaction fee" means any fee established, charged or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit transaction.

(9) Issuer. The term "issuer" means any person who issues a debit card, or credit card, or the agent of such person with respect to such card.

(10) Network fee. The term “network fee” means any fee charged and received by a payment card network with respect to an electronic debit transaction, other than an interchange transaction fee.

(11) Payment card network. The term “payment card network” means an entity that directly, or through licensed members, processors, or agents, provides the proprietary services, infrastructure, and software that route information and data to conduct debit card or credit card transaction authorization, clearance, and settlement, and that a person uses in order to accept as a form of payment a brand of debit card, credit card or other device that may be used to carry out debit or credit transactions.

(d) Enforcement.

(1) In general. Compliance with the requirements imposed under this section shall be enforced under section 918 [15 USCS § 1693o].

(2) Exception. Sections 916 and 917 [15 USCS §§ 1693m and 1693n] shall not apply with respect to this section or the requirements imposed pursuant to this section.

CREDIT(S):
(May 29, 1968, P.L. 90-321, Title IX, § 920, as added July 21, 2010, P.L. 111-203, Title X, Subtitle G, § 1075(a)(2), 124 Stat. 2068.

PART 235—DEBIT CARD INTERCHANGE FEES AND ROUTING

Sec.
235.1 Authority and purpose.
235.2 Definitions.
235.3 Reasonable and proportional interchange fees.
235.4 Fraud-prevention adjustment.
235.5 Exemptions.
235.6 Prohibition on circumvention, evasion, or net compensation.
235.7 Limitation on payment card restrictions.
235.8 Reporting requirements and record retention.
235.9 Administrative enforcement.
235.10 Effective and compliance dates.
APPENDIX A TO PART 235—OFFICIAL BOARD COMMENTARY ON REGULATION II

AUTHORITY: 15 U.S.C. 1693o–2.

SOURCE: 76 FR 43466, July 20, 2011, unless otherwise noted.

§ 235.1 Authority and purpose.

(a) *Authority*. This part is issued by the Board of Governors of the Federal Reserve System (Board) under section 920 of the Electronic Fund Transfer Act (EFTA) (15 U.S.C. 1693o–2, as added by section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010)).

(b) *Purpose*. This part implements the provisions of section 920 of the EFTA, including standards for reasonable and proportional interchange transaction fees for electronic debit transactions, standards for receiving a fraud-prevention adjustment to interchange transaction fees, exemptions from the interchange transaction fee limitations, prohibitions on evasion and circumvention, prohibitions on payment card network exclusivity arrangements and routing restrictions for debit card transactions, and reporting requirements for debit card issuers and payment card networks.

§ 235.2 Definitions.

For purposes of this part:

(a) *Account* (1) Means a transaction, savings, or other asset account (other than an occasional or incidental credit balance in a credit plan) established for any purpose and that is located in the United States; and

(2) Does not include an account held under a bona fide trust agreement that is excluded by section 903(2) of the Electronic Fund Transfer Act and rules prescribed thereunder.

(b) *Acquirer* means a person that contracts directly or indirectly with a merchant to provide settlement for the merchant's electronic debit transactions over a payment card network. An acquirer does not include a person that acts only as a processor for the services it provides to the merchant.

(c) *Affiliate* means any company that controls, is controlled by, or is under common control with another company.

(d) *Cardholder* means the person to whom a debit card is issued.

(e) *Control* of a company means—

(1) Ownership, control, or power to vote 25 percent or more of the outstanding shares of any class of voting security of the company, directly or indirectly, or acting through one or more other persons;

(2) Control in any manner over the election of a majority of the directors, trustees, or general partners (or individuals exercising similar functions) of the company; or

(3) The power to exercise, directly or indirectly, a controlling influence over the management or policies of the company, as the Board determines.

(f) *Debit card* (1) Means any card, or other payment code or device, issued or approved for use through a payment card network to debit an account, regardless of whether authorization is based on signature, personal identification number (PIN), or other means, and regardless of whether the issuer holds the account, and

(2) Includes any general-use prepaid card; and

(3) Does not include—

(i) Any card, or other payment code or device, that is redeemable upon presentation at only a single merchant or an affiliated group of merchants for goods or services; or

(ii) A check, draft, or similar paper instrument, or an electronic representation thereof.

(g) *Designated automated teller machine (ATM) network* means either—

(1) All ATMs identified in the name of the issuer; or

(2) Any network of ATMs identified by the issuer that provides reasonable and convenient access to the issuer's customers.

(h) *Electronic debit transaction* (1) Means the use of a debit card by a person as a form of payment in the United States to initiate a debit to an account, and

(2) Does not include transactions initiated at an ATM, including cash withdrawals and balance transfers initiated at an ATM.

(i) *General-use prepaid card* means a card, or other payment code or device, that is—

(1) Issued on a prepaid basis in a specified amount, whether or not that amount may be increased or reloaded, in exchange for payment; and

(2) Redeemable upon presentation at multiple, unaffiliated merchants for goods or services.

(j) *Interchange transaction fee* means any fee established, charged, or received by a payment card network and paid by a merchant or an acquirer for the purpose of compensating an issuer for its involvement in an electronic debit transaction.

(k) *Issuer* means any person that authorizes the use of a debit card to perform an electronic debit transaction.

(l) *Merchant* means any person that accepts debit cards as payment.

(m) *Payment card network* means an entity that—

(1) Directly or indirectly provides the proprietary services, infrastructure, and software that route information and data to an issuer from an acquirer to conduct the authorization, clearance, and settlement of electronic debit transactions; and

(2) A merchant uses in order to accept as a form of payment a brand of debit card or other device that may be used to carry out electronic debit transactions.

(n) *Person* means a natural person or an organization, including a corporation, government agency, estate, trust, partnership, proprietorship, cooperative, or association.

(o) *Processor* means a person that processes or routes electronic debit transactions for issuers, acquirers, or merchants.

(p) *Route* means to direct and send information and data to an unaffiliated entity or to an affiliated entity acting on behalf of an unaffiliated entity.

(q) *United States* means the States, territories, and possessions of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any political subdivision of any of the foregoing.

§ 235.3 Reasonable and proportional interchange transaction fees.

(a) *In general.* 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 electronic debit transaction.

(b) *Determination of reasonable and proportional fees.* An issuer complies with the requirements of paragraph (a) of this section only if each interchange transaction fee received or charged by the issuer for an electronic debit transaction is no more than the sum of—

(1) 21 cents and;

(2) 5 basis points multiplied by the value of the transaction.

§ 235.4 Fraud-prevention adjustment.

(a) *In general.* Subject to paragraph (b) of this section, an issuer may receive or charge an amount of no more than 1 cent per transaction in addition to any interchange transaction fee it receives or charges in accordance with § 235.3.

(b) *Issuer standards.* (1) To be eligible to receive or charge the fraud-prevention adjustment in paragraph (a) of this section, an issuer must develop and implement policies and procedures reasonably designed to take effective steps to reduce the occurrence of, and costs to all parties from, fraudulent electronic debit transactions, including through the development and implementation of cost-effective fraud-prevention technology.

(2) An issuer's policies and procedures must address—

(i) Methods to identify and prevent fraudulent electronic debit transactions;

(ii) Monitoring of the volume and value of its fraudulent electronic debit transactions;

(iii) Appropriate responses to suspicious electronic debit transactions in a manner designed to limit the costs to all parties from and prevent the occurrence of future fraudulent electronic debit transactions;

(iv) Methods to secure debit card and cardholder data; and

(v) Such other factors as the issuer considers appropriate.

(3) An issuer must review, at least annually, its fraud-prevention policies and procedures, and their implementation and update them as necessary in light of—

(i) Their effectiveness in reducing the occurrence of, and cost to all parties from, fraudulent electronic debit transactions involving the issuer;

(ii) Their cost-effectiveness; and

(iii) Changes in the types of fraud, methods used to commit fraud, and available methods for detecting and

preventing fraudulent electronic debit transactions that the issuer identifies from—

(A) Its own experience or information;

(B) Information provided to the issuer by its payment card networks, law enforcement agencies, and fraud-monitoring groups in which the issuer participates; and

(C) Applicable supervisory guidance.

(c) *Notification.* To be eligible to receive or charge a fraud-prevention adjustment, an issuer must annually notify its payment card networks that it complies with the standards in paragraph (b) of this section.

(d) *Change in Status.* An issuer is not eligible to receive or charge a fraud-prevention adjustment if the issuer is substantially non-compliant with the standards set forth in paragraph (b) of this section, as determined by the issuer or the appropriate agency under § 235.9. Such an issuer must notify its payment card networks that it is no longer eligible to receive or charge a fraud-prevention adjustment no later than 10 days after determining or receiving notification from the appropriate agency under § 235.9 that the issuer is substantially non-compliant with the standards set forth in paragraph (b) of this section. The issuer must stop receiving and charging the fraud-prevention adjustment no later than 30 days after notifying its payment card networks.

[77 FR 46280, Aug. 3, 2012]

§ 235.5 Exemptions.

(a) *Exemption for small issuers.* (1) *In general.* Except as provided in paragraph (a)(3) of this section, §§ 235.3, 235.4, and 235.6 do not apply to an interchange transaction fee received or charged by an issuer with respect to an electronic debit transaction if—

(i) The issuer holds the account that is debited; and

(ii) The issuer, together with its affiliates, has assets of less than $10 billion as of the end of the calendar year preceding the date of the electronic debit transaction.

(2) *Determination of issuer asset size.* A person may rely on lists published by the Board to determine whether an issuer, together with its affiliates, has assets of less than $10 billion as of the end of the calendar year preceding the date of the electronic debit transaction.

(3) *Change in status.* If an issuer qualifies for the exemption in paragraph (a)(1) in a particular calendar year, but, as of the end of that calendar year no longer qualifies for the exemption because at that time it, together with its affiliates, has assets of $10 billion or more, the issuer must begin complying with §§ 235.3, 235.4, and 235.6 no later than July 1 of the succeeding calendar year.

(b) *Exemption for government-administered programs.* Except as provided in paragraph (d) of this section, §§ 235.3, 235.4, and 235.6 do not apply to an interchange transaction fee received or charged by an issuer with respect to an electronic debit transaction if—

(1) The electronic debit transaction is made using a debit card that has been provided to a person pursuant to a Federal, State, or local government-administered payment program; and

(2) The cardholder may use the debit card only to transfer or debit funds, monetary value, or other assets that have been provided pursuant to such program.

(c) *Exemption for certain reloadable prepaid cards*—(1) *In general.* Except as provided in paragraph (d) of this section, §§ 235.3, 235.4, and 235.6 do not apply to an interchange transaction fee received or charged by an issuer with respect to an electronic debit transaction using a general-use prepaid card that is—

(i) Not issued or approved for use to access or debit any account held by or for the benefit of the cardholder (other than a subaccount or other method of recording or tracking funds purchased or loaded on the card on a prepaid basis);

(ii) Reloadable and not marketed or labeled as a gift card or gift certificate; and

(iii) The only means of access to the underlying funds, except when all remaining funds are provided to the cardholder in a single transaction.

(2) *Temporary cards.* For purposes of this paragraph (c), the term ''reloadable'' includes a temporary non-reloadable card issued solely in

connection with a reloadable general-use prepaid card.

(d) *Exception.* The exemptions in paragraphs (b) and (c) of this section do not apply to any interchange transaction fee received or charged by an issuer on or after July 21, 2012, with respect to an electronic debit transaction if any of the following fees may be charged to a cardholder with respect to the card:

(1) A fee or charge for an overdraft, including a shortage of funds or a transaction processed for an amount exceeding the account balance, unless the fee or charge is imposed for transferring funds from another asset account to cover a shortfall in the account accessed by the card; or

(2) A fee imposed by the issuer for the first withdrawal per calendar month from an ATM that is part of the issuer's designated ATM network.

§ 235.6 Prohibition on circumvention, evasion, and net compensation.

(a) *Prohibition of circumvention or evasion.* No person shall circumvent or evade the interchange transaction fee restrictions in §§ 235.3 and 235.4.

(b) *Prohibition of net compensation.* An issuer may not receive net compensation from a payment card network with respect to electronic debit transactions or debit card-related activities within a calendar year. Net compensation occurs when the total amount of payments or incentives received by an issuer from a payment card network with respect to electronic debit transactions or debit card-related activities, other than interchange transaction fees passed through to the issuer by the network, during a calendar year exceeds the total amount of all fees paid by the issuer to the network with respect to electronic debit transactions or debit card-related activities during that calendar year. Payments and incentives paid by a network to an issuer, and fees paid by an issuer to a network, with respect to electronic debit transactions or debit card related activities are not limited to volume-based or transaction-specific payments, incentives, or fees, but also include other payments, incentives or fees related to an issuer's provision of debit card services.

§ 235.7 Limitations on payment card restrictions.

(a) *Prohibition on network exclusivity*—(1) *In general.* An issuer or payment card network shall not directly or through any agent, processor, or licensed member of a payment card network, 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 networks.

(2) *Permitted arrangements.* An issuer satisfies the requirements of paragraph (a)(1) of this section only if the issuer allows an electronic debit transaction to be processed on at least two unaffiliated payment card networks, each of which does not, by rule or policy, restrict the operation of the network to a limited geographic area, specific merchant, or particular type of merchant or transaction, and each of which has taken steps reasonably designed to enable the network to process the electronic debit transactions that the network would reasonably expect will be routed to it, based on expected transaction volume.

(3) *Prohibited exclusivity arrangements by networks.* For purposes of paragraph (a)(1) of this section, a payment card network may not restrict or otherwise limit an issuer's ability to contract with any other payment card network that may process an electronic debit transaction involving the issuer's debit cards.

(4) *Subsequent affiliation.* If unaffiliated payment card networks become affiliated as a result of a merger or acquisition such that an issuer is no longer in compliance with paragraph (a) of this section, the issuer must add an unaffiliated payment card network through which electronic debit transactions on the relevant debit card may be processed no later than six months after the date on which the previously unaffiliated payment card networks consummate the affiliation.

(b) *Prohibition on routing restrictions.* An issuer or payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement,

condition, penalty, or otherwise, inhibit the ability of any person that accepts or honors debit cards for payments to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions.

(c) *Compliance dates*—(1) *General*. Except as otherwise provided in paragraphs (c)(2), (c)(3), and (c)(4) of this section, the compliance date of paragraph (a) of this section is April 1, 2012.

(2) *Restrictions by payment card networks*. The compliance date of paragraphs (a)(1) and (a)(3) of this section for payment card networks is October 1, 2011.

(3) *Debit cards that use transaction qualification or substantiation systems*. Issuers shall comply with the requirements of paragraph (a) of this section by April 1, 2013, for electronic debit transactions using debit cards that use point-of-sale transaction qualification or substantiation systems for verifying the eligibility of purchased goods or services.

(4) *General-use prepaid cards*. Issuers shall comply with the requirements of paragraph (a) of this section with respect to general-use prepaid cards as set out below.

(i) With respect to non-reloadable general-use prepaid cards, the compliance date is April 1, 2013. Non-reloadable general-use prepaid cards sold prior to April 1, 2013 are not subject to paragraph (a) of this section.

(ii) With respect to reloadable general-use prepaid cards, the compliance date is April 1, 2013. Reloadable general-use prepaid cards sold prior to April 1, 2013 are not subject to paragraph (a) of this section unless and until they are reloaded, in which case the following compliance dates apply:

(A) With respect to reloadable general-use prepaid cards sold and reloaded prior to April 1, 2013, the compliance date is May 1, 2013.

(B) With respect to reloadable general-use prepaid cards sold prior to April 1, 2013, and reloaded on or after April 1, 2013, the compliance date is 30 days after the date of reloading.

§ 235.8 Reporting requirements and record retention.

(a) *Entities required to report*. Each issuer that is not otherwise exempt from the requirements of this part under § 235.5(a) and each payment card network shall file a report with the Board in accordance with this section.

(b) *Report*. Each entity required to file a report with the Board shall submit data in a form prescribed by the Board for that entity. Data required to be reported may include, but may not be limited to, data regarding costs incurred with respect to an electronic debit transaction, interchange transaction fees, network fees, fraud-prevention costs, fraud losses, and transaction value, volume, and type.

(c) *Record retention*. (1) An issuer subject to this part shall retain evidence of compliance with the requirements imposed by this part for a period of not less than five years after the end of the calendar year in which the electronic debit transaction occurred.

(2) Any person subject to this part having actual notice that it is the subject of an investigation or an enforcement proceeding by its enforcement agency shall retain the records that pertain to the investigation, action, or proceeding until final disposition of the matter unless an earlier time is allowed by court or agency order.

§ 235.9 Administrative enforcement.

(a) (1) Compliance with the requirements of this part shall be enforced under—

(i) Section 8 of the Federal Deposit Insurance Act, by the appropriate Federal banking agency, as defined in section 3(q) of the Federal Deposit Insurance Act (12 U.S.C. 1813(q)), with respect to—

(A) National banks, federal savings associations, and federal branches and federal agencies of foreign banks;

(B) Member banks of the Federal Reserve System (other than national banks), branches and agencies of foreign banks (other than federal branches, federal Agencies, and insured state branches of foreign banks), commercial lending companies owned or controlled by foreign banks, and organizations operating under section 25 or 25A of the Federal Reserve Act;

(C) Banks and state savings associations insured by the Federal Deposit Insurance Corporation (other than members of the Federal Reserve System), and insured state branches of foreign banks;

(ii) The Federal Credit Union Act (12 U.S.C. 1751 *et seq.*), by the Administrator of the National Credit Union Administration (National Credit Union Administration Board) with respect to any federal credit union;

(iii) The Federal Aviation Act of 1958 (49 U.S.C. 40101 *et seq.*), by the Secretary of Transportation, with respect to any air carrier or foreign air carrier subject to that Act; and

(iv) The Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*), by the Securities and Exchange Commission, with respect to any broker or dealer subject to that Act.

(2) The terms used in paragraph (a)(1) of this section that are not defined in this part or otherwise defined in section 3(s) of the Federal Deposit Insurance Act (12 U.S.C. 1813(s)) shall have the meaning given to them in section 1(b) of the International Banking Act of 1978 (12 U.S.C. 3101).

(b) *Additional powers.* (1) For the purpose of the exercise by any agency referred to in paragraphs (a)(1)(i) through (a)(1)(iv) of this section of its power under any statute referred to in those paragraphs, a violation of this part is deemed to be a violation of a requirement imposed under that statute.

(2) In addition to its powers under any provision of law specifically referred to in paragraphs (a)(1)(i) through (a)(1)(iv) of this section, each of the agencies referred to in those paragraphs may exercise, for the purpose of enforcing compliance under this part, any other authority conferred on it by law.

(c) *Enforcement authority of Federal Trade Commission.* Except to the extent that enforcement of the requirements imposed under this title is specifically granted to another government agency under paragraphs (a)(1)(i) through (a)(1)(iv) of this section, and subject to subtitle B of the Consumer Financial Protection Act of 2010, the Federal Trade Commission has the authority to enforce such requirements. For the purpose of the exercise by the Federal Trade Commission of its functions and powers under the Federal Trade Commission Act, a violation of this part shall be deemed a violation of a requirement imposed under the Federal Trade Commission Act. All of the functions and powers of the Federal Trade Commission under the Federal Trade Commission Act are available to the Federal Trade Commission to enforce compliance by any person subject to the jurisdiction of the Federal Trade Commission with the requirements of this part, regardless of whether that person is engaged in commerce or meets any other jurisdictional tests under the Federal Trade Commission Act.

§ 235.10 Effective and compliance dates.

Except as provided in § 235.7, this part becomes effective and compliance is mandatory on October 1, 2011.

APPENDIX A TO PART 235—OFFICIAL BOARD COMMENTARY ON REGULATION II

INTRODUCTION

The following commentary to Regulation II (12 CFR part 235) provides background material to explain the Board's intent in adopting a particular part of the regulation. The commentary also provides examples to aid in understanding how a particular requirement is to work.

SECTION 235.2 DEFINITIONS

2(a) Account

1. *Types of accounts.* The term ''account'' includes accounts held by any person, including consumer accounts (*i.e.*, those established primarily for personal, family or household purposes) and business accounts. Therefore, the limitations on interchange transaction fees and the prohibitions on network exclusivity arrangements and routing restrictions apply to all electronic debit transactions, regardless of whether the transaction involves a debit card issued primarily for personal, family, or household purposes or for business purposes. For example, an issuer of a business-purpose debit card is subject to the restrictions on interchange transaction fees and is also prohibited from restricting the number of payment card networks on which an electronic debit transaction may be processed under § 235.7.

2. *Bona fide trusts.* This part does not define the term bona fide trust agreement; therefore, institutions must look to state or other applicable law for interpretation. An account

held under a custodial agreement that qualifies as a trust under the Internal Revenue Code, such as an individual retirement account, is considered to be held under a trust agreement for purposes of this part.

3. *Account located in the United States.* This part applies only to electronic debit transactions that are initiated to debit (or credit, for example, in the case of returned goods or cancelled services) an account located in the United States. If a cardholder uses a debit card to debit an account held outside the United States, then the electronic debit transaction is not subject to this part.

2(b) Acquirer

1. *In general.* The term ''acquirer'' includes only the institution that contracts, directly or indirectly, with a merchant to provide settlement for the merchant's electronic debit transactions over a payment card network (referred to as acquiring the merchant's electronic debit transactions). In some acquiring relationships, an institution provides processing services to the merchant and is a licensed member of the payment card network, but does not settle the transactions with the merchant (by crediting the merchant's account) or with the issuer. These institutions are not ''acquirers'' because they do not provide credit to the merchant for the transactions or settle the merchant's transactions with the issuer. These institutions are considered processors and in some circumstances may be considered payment card networks for purposes of this part (*See* §§235.2(m), 235.2(o), and commentary thereto).

2(c) Affiliate

1. *Types of entities.* The term ''affiliate'' includes any bank and nonbank affiliates located in the United States or a foreign country.

2. *Other affiliates.* For commentary on whether merchants are affiliated, see comment 2(f)–7.

2(d) Cardholder

1. *Scope.* In the case of debit cards that access funds in transaction, savings, or other similar asset accounts, ''the person to whom a card is issued'' generally will be the named person or persons holding the account. If the account is a business account, multiple employees (or other persons associated with the business) may have debit cards that can access the account. Each employee that has a debit card that can access the account is a cardholder. In the case of a prepaid card, the cardholder generally is either the purchaser of the card or a person to whom the purchaser gave the card, such as a gift recipient.

2(e) Control [Reserved]

2(f) Debit Card

1. *Card, or other payment code or device.* The term ''debit card'' as defined in §235.2(f) applies to any card, or other payment code or device, even if it is not issued in a physical form. Debit cards include, for example, an account number or code that can be used to access funds in an account to make Internet purchases. Similarly, the term ''debit card'' includes a device with a chip or other embedded mechanism, such as a mobile phone or sticker containing a contactless chip that links the device to funds stored in an account, and enables an account to be debited. The term ''debit card,'' however, does not include a one-time password or other code if such password or code is used for the purposes of authenticating the cardholder and is used in addition to another card, or other payment code or device, rather than as the payment code or device.

2. *Deferred debit cards.* The term ''debit card'' includes a card, or other payment code or device, that is used in connection with deferred debit card arrangements in which transactions are not immediately posted to and funds are not debited from the underlying transaction, savings, or other asset account upon settlement of the transaction. Instead, the funds in the account typically are held and made unavailable for other transactions for a period of time specified in the issuer-cardholder agreement. After the expiration of the time period, the cardholder's account is debited for the value of all transactions made using the card that have been submitted to the issuer for settlement during that time period. For example, under some deferred debit card arrangements, the issuer may debit the consumer's account for all debit card transactions that occurred during a particular month at the end of the month. Regardless of the time period between the transaction and account posting, a card, or other payment code or device, that is used in connection with a deferred debit arrangement is considered a debit card for purposes of the requirements of this part.

3. *Decoupled debit cards.* Decoupled debit cards are issued by an entity other than the financial institution holding the cardholder's account. In a decoupled debit arrangement, transactions that are authorized by the card issuer settle against the cardholder's account held by an entity other than the issuer, generally via a subsequent ACH debit to that account. The term ''debit card'' includes any card, or other payment code or device, issued or approved for use through a payment card network to debit an account, regardless of whether the issuer holds the account. Therefore, decoupled

debit cards are debit cards for purposes of this part.

4. *Hybrid cards.*

i. Some cards, or other payment codes or devices, may have both credit- and debit-like features (''hybrid cards''). For example, these cards may enable a cardholder to access a line of credit, but select certain transactions for immediate repayment (*i.e.*, prior to the end of a billing cycle) via a debit to the cardholder's account, as the term is defined in §235.2(a), held either with the issuer or at another institution. If a card permits a cardholder to initiate transactions that debit an account or funds underlying a prepaid card, the card is considered a debit card for purposes of this part. Not all transactions initiated by such a hybrid card, however, are electronic debit transactions. Rather, only those transactions that debit an account as defined in this part or funds underlying a prepaid card are electronic debit transactions. If the transaction posts to a line of credit, then the transaction is a credit transaction.

ii. If an issuer conditions the availability of a credit or charge card that permits preauthorized repayment of some or all transactions on the cardholder maintaining an account at the issuer, such a card is considered a debit card for purposes of this part.

5. *Virtual wallets.* A virtual wallet is a device (*e.g.*, a mobile phone) that stores several different payment codes or devices (''virtual cards'') that access different accounts, funds underlying the card, or lines of credit. At the point of sale, the cardholder may select from the virtual wallet the virtual card he or she wishes to use for payment. The virtual card that the cardholder uses for payment is considered a debit card under this part if the virtual card that initiates a transaction meets the definition of debit card, notwithstanding the fact that other cards in the wallet may not be debit cards.

6. *General-use prepaid card.* The term ''debit card'' includes general-use prepaid cards. See §235.2(i) and related commentary for information on general-use prepaid cards.

7. *Store cards.* The term ''debit card'' does not include prepaid cards that may be used at a single merchant or affiliated merchants. Two or more merchants are affiliated if they are related by either common ownership or by common corporate control. For purposes of the ''debit card'' definition, franchisees are considered to be under common corporate control if they are subject to a common set of corporate policies or practices under the terms of their franchise licenses.

8. *Checks, drafts, and similar instruments.* The term ''debit card'' does not include a check, draft, or similar paper instrument or a transaction in which the check is used as a source of information to initiate an electronic payment. For example, if an account holder provides a check to buy goods or services and the merchant takes the account number and routing number information from the MICR line at the bottom of a check to initiate an ACH debit transfer from the cardholder's account, the check is not a debit card, and such a transaction is not considered an electronic debit transaction. Likewise, the term ''debit card'' does not include an electronic representation of a check, draft, or similar paper instrument.

9. *ACH transactions.* The term ''debit card'' does not include an account number when it is used by a person to initiate an ACH transaction that debits that person's account. For example, if an account holder buys goods or services over the Internet using an account number and routing number to initiate an ACH debit, the account number is not a debit card, and such a transaction is not considered an electronic debit transaction. However, the use of a card to purchase goods or services that debits the cardholder's account that is settled by means of a subsequent ACH debit initiated by the card issuer to the cardholder's account, as in the case of a decoupled debit card arrangement, involves the use of a debit card for purposes of this part.

2(g) Designated Automated Teller Machine (ATM) Network

1. *Reasonable and convenient access clarified.* Under §235.2(g)(2), a designated ATM network includes any network of ATMs identified by the issuer that provides reasonable and convenient access to the issuer's cardholders. Whether a network provides reasonable and convenient access depends on the facts and circumstances, including the distance between ATMs in the designated network and each cardholder's last known home or work address, or if a home or work address is not known, where the card was first issued.

2(h) Electronic Debit Transaction

1. *Debit an account.* The term ''electronic debit transaction'' includes the use of a card to debit an account. The account debited could be, for example, the cardholder's asset account or the account that holds the funds used to settle prepaid card transactions.

2. *Form of payment.* The term ''electronic debit transaction'' includes the use of a card as a form of payment that may be made in exchange for goods or services, as a charitable contribution, to satisfy an obligation (*e.g.*, tax liability), or for other purposes.

3. *Subsequent transactions.* The term ''electronic debit transaction'' includes both the cardholder's use of a debit card for the initial payment and any subsequent use by the cardholder of the debit card in connection with the initial payment. For example, the term ''electronic debit transaction'' includes using the debit card to return merchandise or cancel a service that then results in a

debit to the merchant's account and a credit to the cardholder's account.

4. *Cash withdrawal at the point of sale.* The term ''electronic debit transaction'' includes a transaction in which a cardholder uses the debit card both to make a purchase and to withdraw cash (known as a ''cash-back transaction'').

5. *Geographic limitation.* This regulation applies only to electronic debit transactions that are initiated at a merchant located in the United States. If a cardholder uses a debit card at a merchant located outside the United States to debit an account held in the United States, the electronic debit transaction is not subject to this part.

2(i) General-Use Prepaid Card

1. *Redeemable upon presentation at multiple, unaffiliated merchants.* A prepaid card is redeemable upon presentation at multiple, unaffiliated merchants if such merchants agree to honor the card.

2. *Selective authorization cards.* Selective authorization cards, (*e.g.*, mall cards) are generally intended to be used or redeemed for goods or services at participating retailers within a shopping mall or other limited geographic area. Selective authorization cards are considered general-use prepaid cards, regardless of whether they carry the mark, logo, or brand of a payment card network, if they are redeemable at multiple, unaffiliated merchants.

2(j) Interchange Transaction fee

1. *In general.* Generally, the payment card network is the entity that establishes and charges the interchange transaction fee to the acquirers or merchants. The acquirers then pay to the issuers any interchange transaction fee established and charged by the network. Acquirers typically pass the interchange transaction fee through to merchant-customers.

2. *Compensating an issuer.* The term ''interchange transaction fee'' is limited to those fees that a payment card network establishes, charges, or receives to compensate the issuer for its role in the electronic debit transaction. By contrast, payment card networks generally charge issuers and acquirers fees for services the network performs. Such fees are not interchange transaction fees because the payment card network is charging and receiving the fee as compensation for services it provides.

3. *Established, charged, or received.* Interchange transaction fees are not limited to those fees for which a payment card network sets the value. A fee that compensates an issuer is an interchange transaction fee if the fee is set by the issuer but charged to acquirers by virtue of the network determining each participant's net settlement position.

2(k) Issuer

1. *In general.* A person issues a debit card by authorizing the use of debit card by a cardholder to perform electronic debit transactions. That person may provide the card directly to the cardholder or indirectly by using a third party (such as a processor, or a telephone network or manufacturer) to provide the card, or other payment code or device, to the cardholder. The following examples illustrate the entity that is the issuer under various card program arrangements. For purposes of determining whether an issuer is exempted under §235.5(a), however, the term issuer is limited to the entity that holds the account being debited.

2. *Traditional debit card arrangements.* In a traditional debit card arrangement, the bank or other entity holds the cardholder's funds and authorizes the cardholder to use the debit card to access those funds through electronic debit transactions, and the cardholder receives the card directly or indirectly (*e.g.*, through an agent) from the bank or other entity that holds the funds (except for decoupled debit cards, discussed below). In this system, the bank or entity holding the cardholder's funds is the issuer.

3. *BIN-sponsor arrangements.* Payment card networks assign Bank Identification Numbers (BINs) to member-institutions for purposes of issuing cards, authorizing, clearing, settling, and other processes. In exchange for a fee or other financial considerations, some members of payment card networks permit other entities to issue debit cards using the member's BIN. The entity permitting the use of its BIN is referred to as the ''BIN sponsor'' and the entity that uses the BIN to issue cards is often referred to as the ''affiliate member.'' BIN sponsor arrangements can follow at least two different models:

i. *Sponsored debit card model.* In some cases, a community bank or credit union may provide debit cards to its account holders through a BIN sponsor arrangement with a member institution. In general, the bank or credit union will authorize its account holders to use debit cards to perform electronic debit transactions that access funds in accounts at the bank or credit union. The bank or credit union's name typically will appear on the debit card. The bank or credit union may directly or indirectly provide the cards to cardholders. Under these circumstances, the bank or credit union is the issuer for purposes of this part. If that bank or credit union, together with its affiliates, has assets of less than $10 billion, then that bank or credit union is exempt from the interchange transaction fee restrictions. Although the bank or credit union may distribute cards through the BIN sponsors, the BIN sponsor does not enter into the agreement with the cardholder that authorizes the cardholder to use the card to perform electronic debit

transactions that access funds in the account at the bank or credit union, and therefore the BIN sponsor is not the issuer.

ii. *Prepaid card model.* A member institution may also serve as the BIN sponsor for a prepaid card program. Under these arrangements, a program manager distributes prepaid cards to the cardholders and the BIN-sponsoring institution generally holds the funds for the prepaid card program in an omnibus or pooled account. Either the BIN sponsor or the prepaid card program manager may keep track of the underlying funds for each individual prepaid card through subaccounts. While the cardholder may receive the card directly from the program manager or at a retailer, the BIN sponsor authorizes the cardholder to use the card to perform electronic debit transactions that access the funds in the pooled account and the cardholder's relationship generally is with the BIN sponsor. Accordingly, under these circumstances, the BIN sponsor, or the bank holding the pooled account, is the issuer.

4. *Decoupled debit cards.* In the case of decoupled debit cards, an entity other than the bank holding the cardholder's account enters into a relationship with the cardholder authorizing the use of the card to perform electronic debit transactions. The entity authorizing the use of the card to perform electronic debit transaction typically arranges for the card to be provided directly or indirectly to the cardholder and has a direct relationship with the cardholder with respect to the card. The bank holding the cardholder's account has agreed generally to permit ACH debits to the account, but has not authorized the use of the debit card to access the funds through electronic debit transactions. Under these circumstances, the entity authorizing the use of the debit card, and not the account-holding institution, is considered the issuer. An issuer of a decoupled debit card is not exempt under §235.5(a), even if, together with its affiliates, it has assets of less than $10 billion, because it is not the entity holding the account to be debited.

2(l) Merchant [Reserved]

2(m) Payment Card Network

1. *In general.* An entity is a considered a payment card network with respect to an electronic debit transaction for purposes of this rule if it routes information and data to the issuer from the acquirer to conduct authorization, clearance, and settlement of the electronic debit transaction. By contrast, if an entity receives transaction information and data from a merchant and authorizes and settles the transaction without routing the information and data to another entity (*i.e.*, the issuer or the issuer's processor) for authorization, clearance, or settlement, that entity is not considered a payment card network with respect to the electronic debit transaction.

2. *Three-party systems.* In the case of a three-party system, electronic debit transactions are processed by an entity that acts as system operator and issuer, and may also act as the acquirer. The entity acting as system operator and issuer that receives the transaction information from the merchant or acquirer also holds the cardholder's funds. Therefore, rather than directing the transaction information to a separate issuer, the entity authorizes and settles the transaction based on the information received from the merchant. As these entities do not connect (or "network") multiple issuers and do not route information to conduct the transaction, they are not "payment card networks" with respect to these transactions.

3. *Processors as payment card networks.* A processor is considered a payment card network if, in addition to acting as processor for an acquirer and issuer, the processor routes transaction information and data received from a merchant or the merchant's acquirer to an issuer. For example, if a merchant uses a processor in order to accept any, some, or all brands of debit cards and the processor routes transaction information and data to the issuer or issuer's processor, the merchant's processor is considered a payment card network with respect to the electronic debit transaction. If the processor establishes, charges, or receives a fee for the purpose of compensating an issuer, that fee is considered an interchange transaction fee for purposes of this part.

4. *Automated clearing house (ACH) operators.* An ACH operator is not considered a payment card network for purposes of this part. While an ACH operator processes transactions that debit an account and provides for interbank clearing and settlement of such transactions, a person does not use the ACH system to accept as a form of payment a brand of debit card.

5. *ATM networks.* An ATM network is not considered a payment card network for purposes of this part. While ATM networks process transactions that debit an account and provide for interbank clearing and settlement of such transactions, a cash withdrawal from an ATM is not a payment because there is no exchange of money for goods or services, or payment made as a charitable contribution, to satisfy an obligation (*e.g.*, tax liability), or for other purposes.

2(n) Person [Reserved]

2(o) Processor

1. *Distinction from acquirers.* A processor may perform all transaction-processing functions for a merchant or acquirer, but if it does not acquire (that is, settle with the merchant for the transactions), it is not an

acquirer. The entity that acquirers electronic debit transactions is the entity that is responsible to other parties to the electronic debit transaction for the amount of the transaction.

2. *Issuers.* A processor may perform services related to authorization, clearance, and settlement of transactions for an issuer without being considered to be an issuer for purposes of this part.

2(p) Route

1. An entity routes information if it both directs and sends the information to an unaffiliated entity (or affiliated entity acting on behalf of the unaffiliated entity). This other entity may be a payment card network or processor (if the entity directing and sending the information is a merchant or an acquirer) or an issuer or processor (if the entity directing and sending the information is a payment card network).

2(q) United States [Reserved]

SECTION 235.3 REASONABLE AND PROPORTIONAL INTERCHANGE TRANSACTION FEES

3(a) [Reserved]

3(b) Determining Reasonable and Proportional Fees

1. *Two components.* The standard for the maximum permissible interchange transaction fee that an issuer may receive consists of two components: a base component that does not vary with a transaction's value and an *ad valorem* component. The amount of any interchange transaction fee received or charged by an issuer may not exceed the sum of the maximum permissible amounts of each component and any fraud-prevention adjustment the issuer is permitted to receive under §235.4 of this part.

2. *Variation in interchange fees.* An issuer is permitted to charge or receive, and a network is permitted to establish, interchange transaction fees that vary in their base component and *ad valorem* component based on, for example, the type of transaction or merchant, provided the amount of any interchange transaction fee for any transaction does not exceed the sum of the maximum permissible base component of 21 cents and 5 basis points of the value of the transaction.

3. *Example.* For a $39 transaction, the maximum permissible interchange transaction fee is 22.95 cents (21 cents plus 5 basis points of $39). A payment card network may, for example, establish an interchange transaction fee of 22 cents without any *ad valorem* component.

SECTION 235.4 FRAUD-PREVENTION ADJUSTMENT

4(b) Issuer Standards

SECTION 235.4 FRAUD-PREVENTION ADJUSTMENT

4(a) [Reserved]

4(b)(1) Issuer standards

1. An issuer's policies and procedures should address fraud related to debit card use by unauthorized persons. Examples of use by unauthorized persons include, but are not limited to, the following:

i. A thief steals a cardholder's wallet and uses the debit card to purchase goods, without the authority of the cardholder.

ii. A cardholder makes a purchase at a merchant. Subsequently, the merchant's employee uses information from the debit card to initiate a subsequent transaction, without the authority of the cardholder.

iii. A hacker steals cardholder account information from the issuer or a merchant processor and uses the stolen information to make unauthorized card-not-present purchases or to create a counterfeit card to make unauthorized card-present purchases.

2. An issuer's policies and procedures must be designed to reduce fraud, where cost effective, across all types of electronic debit transactions in which its cardholders engage. Therefore, an issuer should consider whether its policies and procedures are effective for each method used to authenticate the card (*e.g.*, a chip or a code embedded in the magnetic stripe) and the cardholder (*e.g.*, a signature or a PIN), and for different sales channels (e.g., card-present and card-not-present).

3. An issuer's policies and procedures must be designed to take effective steps to reduce both the occurrence of and costs to all parties from fraudulent electronic debit transactions. An issuer should take steps reasonably designed to reduce the number and value of its fraudulent electronic debit transactions relative to its non-fraudulent electronic debit transactions. These steps should reduce the costs from fraudulent transactions to all parties, not merely the issuer. For example, an issuer should take steps to reduce the number and value of its fraudulent electronic debit transactions relative to its non-fraudulent transactions whether or not it bears the fraud losses as a result of regulations or network rules.

4. For any given issuer, the number and value of fraudulent electronic debit transactions relative to non-fraudulent transactions may vary materially from year to year. Therefore, in certain circumstances, an issuer's policies and procedures may be effective notwithstanding a relative increase in the transactions that are fraudulent in a

particular year. However, continuing increases in the share of fraudulent transactions would warrant further scrutiny.

5. In determining which fraud-prevention technologies to implement or retain, an issuer must consider the cost-effectiveness of the technology, that is, the expected cost of the technology relative to its expected effectiveness in controlling fraud. In evaluating the cost of a particular technology, an issuer should consider whether and to what extent other parties will incur costs to implement the technology, even though an issuer may not have complete information about the costs that may be incurred by other parties, such as the cost of new merchant terminals. In evaluating the costs, an issuer should consider both initial implementation costs and ongoing costs of using the fraud-prevention method.

6. An issuer need not develop fraud-prevention technologies itself to satisfy the standards in §235.4(b). An issuer may implement fraud-prevention technologies that have been developed by a third party that the issuer has determined are appropriate under its own policies and procedures.

Paragraph 4(b)(2) Elements of fraud-prevention policies and procedures.

1. *In general.* An issuer may tailor its policies and procedures to address its particular debit card program, including the size of the program, the types of transactions in which its cardholders commonly engage, fraud types and methods experienced by the issuer, and the cost of implementing new fraud-prevention methods in light of the expected fraud reduction.

Paragraph 4(b)(2)(i). Methods to identify and prevent fraudulent debit card transactions.

1. *In general.* Examples of policies and procedures reasonably designed to identify and prevent fraudulent electronic debit transactions include the following:

i. Practices to help determine whether a card is authentic and whether the user is authorized to use the card at the time of a transaction. For example, an issuer may specify the use of particular authentication technologies or methods, such as dynamic data, to better authenticate a card and cardholder at the time of the transaction, to the extent doing so does not inhibit the ability of a merchant to direct the routing of electronic debit transactions for processing over any payment card network that may process such transactions. (*See* §235.7 and commentary thereto.)

ii. An automated mechanism to assess the risk that a particular electronic debit transaction is fraudulent during the authorization process (*i.e.*, before the issuer approves or declines an authorization request). For example, an issuer may use neural networks to identify transactions that present increased risk of fraud. As a result of this analysis, the issuer may decide to decline to authorize these transactions. An issuer may not be able to determine whether a given transaction in isolation is fraudulent at the time of authorization, and therefore may have implemented policies and procedures that monitor sets of transactions initiated with a cardholder's debit card. For example, an issuer could compare a set of transactions initiated with the card to a customer's typical transactions in order to determine whether a transaction is likely to be fraudulent. Similarly, an issuer could compare a set of transactions initiated with a debit card and common fraud patterns in order to determine whether a transaction or future transaction is likely to be fraudulent.

iii. Practices to support reporting of lost and stolen cards or suspected incidences of fraud by cardholders or other parties to a transaction. As an example, an issuer may promote customer awareness by providing text alerts of transactions in order to detect fraudulent transactions in a timely manner. An issuer may also report debit cards suspected of being fraudulent to their networks for inclusion in a database of potentially compromised cards.

Paragraph 4(b)(2)(ii). Monitoring of the issuer's volume and value of fraudulent electronic debit transactions.

1. Tracking its fraudulent electronic debit transactions over time enables an issuer to assess whether its policies and procedures are effective. Accordingly, an issuer must include policies and procedures designed to monitor trends in the number and value of its fraudulent electronic debit transactions. An effective monitoring program would include tracking issuer losses from fraudulent electronic debit transactions, fraud-related chargebacks to acquirers, losses passed on to cardholders, and any other reimbursements from other parties. Other reimbursements could include payments made to issuers as a result of fines assessed to merchants for noncompliance with Payment Card Industry (PCI) Data Security Standards or other industry standards. An issuer should also establish procedures to track fraud-related information necessary to perform its reviews under §235.4(b)(3) and to retain and report information as required under §235.8.

Paragraph 4(b)(2)(iii). Appropriate responses to suspicious electronic debit transactions.

1. An issuer may identify transactions that it suspects to be fraudulent after it has authorized or settled the transaction. For example, a cardholder may inform the issuer that the cardholder did not initiate a transaction or transactions, or the issuer may learn of a fraudulent transaction or possibly

compromised debit cards from the network, the acquirer, or other parties. An issuer must implement policies and procedures designed to provide an appropriate response once an issuer has identified suspicious transactions to reduce the occurrence of future fraudulent electronic debit transactions and the costs associated with such transactions. The appropriate response may differ depending on the facts and circumstances, including the issuer's assessment of the risk of future fraudulent electronic debit transactions. For example, in some circumstances, it may be sufficient for an issuer to monitor more closely the account with the suspicious transactions. In other circumstances, it may be necessary to contact the cardholder to verify a transaction, reissue a card, or close an account. An appropriate response may also require coordination with industry organizations, law enforcement agencies, and other parties, such as payment card networks, merchants, and issuer or merchant processors.

Paragraph 4(b)(2)(iv). Methods to secure debit card and cardholder data.

1. An issuer must implement policies and procedures designed to secure debit card and cardholder data. These policies and procedures should apply to data that are transmitted by the issuer (or its service provider) during transaction processing, that are stored by the issuer (or its service provider), and that are carried on media (*e.g.*, laptops, transportable data storage devices) by employees or agents of the issuer. This standard may be incorporated into an issuer's information security program, as required by Section 501(b) of the Gramm-Leach-Bliley Act.

Paragraph 4(b)(3) Review of and updates to policies and procedures.

1. i. An issuer's assessment of the effectiveness of its policies and procedures should consider whether they are reasonably designed to reduce the number and value of fraudulent electronic debit transactions relative to non-fraudulent electronic debit transactions and are cost effective. (*See* comment 4(b)(1)–3 and comment 4(b)(1)–5).

ii. An issuer must also assess its policies and procedures in light of changes in fraud types (*e.g.*, the use of counterfeit cards, lost or stolen cards) and methods (*e.g.*, common purchase patterns indicating possible fraudulent behavior), as well as changes in the available methods of detecting and preventing fraudulent electronic debit transactions (*e.g.*, transaction monitoring, authentication methods) as part of its periodic review of its policies and procedures. An issuer's review of its policies and procedures must consider information from the issuer's own experience and that the issuer otherwise identified itself; information from payment card networks, law enforcement agencies, and fraud-monitoring groups in which the issuer participates; and supervisory guidance. For example, an issuer should consider warnings and alerts it receives from payment card networks regarding compromised cards and data breaches.

2. An issuer should review its policies and procedures and their implementation more frequently than annually if the issuer determines that more frequent review is appropriate based on information obtained from monitoring its fraudulent electronic debit transactions, changes in the types or methods of fraud, or available methods of detecting and preventing fraudulent electronic debit transactions. (*See* §235.4(b)(1)(ii) and commentary thereto.)

3. In light of an issuer's review of its policies and procedures, and their implementation, the issuer may determine that updates to its policies and procedures, and their implementation, are necessary. Merely determining that updates are necessary does not render an issuer ineligible to receive or charge the fraud-prevention adjustment. To remain eligible to receive or charge a fraud-prevention adjustment, however, an issuer should develop and implement such updates as soon as reasonably practicable, in light of the facts and circumstances.

4(c) Notification.

1. Payment card networks that plan to allow issuers to receive or charge a fraud-prevention adjustment can develop processes for identifying issuers eligible for this adjustment. Each issuer that wants to be eligible to receive or charge a fraud-prevention adjustment must notify annually the payment card networks in which it participates of its compliance through the networks' processes.

SECTION 235.5 EXEMPTIONS FOR CERTAIN ELECTRONIC DEBIT TRANSACTIONS

1. *Eligibility for multiple exemptions.* An electronic debit transaction may qualify for one or more exemptions. For example, a debit card that has been provided to a person pursuant to a Federal, State, or local government-administered payment program may be issued by an entity that, together with its affiliates, has assets of less than $10 billion as of the end of the preceding calendar year. In this case, an electronic debit transaction made using that card may qualify for the exemption under §235.5(a) for small issuers or for the exemption under §235.5(b) for government-administered payment programs. A payment card network establishing interchange fees for transactions that qualify for more than one exemption need only satisfy itself that the issuer's transactions qualify for at least one of the exemptions in order to

exempt the electronic debit transaction from the interchange fee restrictions.

2. *Certification process.* Payment card networks that plan to allow issuers to receive higher interchange fees than permitted under §§ 235.3 and 235.4 pursuant to one of the exemptions in § 235.5 could develop their own processes for identifying issuers and products eligible for such exemptions. Section 235.5(a)(2) permits payment card networks to rely on lists published by the Board to help determine eligibility for the small issuer exemption set forth in § 235.5(a)(1).

5(a) Exemption for Small Issuers

1. *Asset size determination.* An issuer would qualify for the small-issuer exemption if its total worldwide banking and nonbanking assets, including assets of affiliates, other than trust assets under management, are less than $10 billion, as of December 31 of the preceding calendar year.

2. *Change in status.* If an exempt issuer becomes covered based on its and its affiliates assets at the end of a calendar year, that issuer must begin complying with the interchange fee standards (§ 235.3), the fraud-prevention adjustment standards (to the extent the issuer wishes to receive a fraud-prevention adjustment) (§ 235.4), and the provisions prohibiting circumvention, evasion, and net compensation (§ 235.6) no later than July 1.

5(b) Exemption for Government-Administered Payment Programs

1. *Government-administered payment program.* A program is considered government-administered regardless of whether a Federal, State, or local government agency operates the program or outsources some or all functions to third parties so long as the program is operated on behalf of the government agency. In addition, a program may be government-administered even if a Federal, State, or local government agency is not the source of funds for the program it administers. For example, child support programs are government-administered programs even though a Federal, State, or local government agency is not the source of funds. A tribal government is considered a local government for purposes of this exemption.

5(c) Exemption for Certain Reloadable Prepaid Cards

1. *Subaccount clarified.* A subaccount is an account within an account, opened in the name of an agent, nominee, or custodian for the benefit of two or more cardholders, where the transactions and balances of individual cardholders are tracked in such subaccounts. An account that is opened solely in the name of a single cardholder is not a subaccount.

2. *Reloadable.* A general-use prepaid card is ''reloadable'' if the terms and conditions of the agreement permit funds to be added to the general-use prepaid card at any time after the initial purchase or issuance. A general-use prepaid card is not ''reloadable'' merely because the issuer or processor is technically able to add functionality that would otherwise enable the general-use prepaid card to be reloaded.

3. *Marketed or labeled as a gift card or gift certificate.* i. Electronic debit transactions made using a reloadable general-use prepaid card are not exempt from the interchange fee restrictions if the card is marketed or labeled as a gift card or gift certificate. The term ''marketed or labeled as a gift card or gift certificate'' means directly or indirectly offering, advertising or otherwise suggesting the potential use of a general-use prepaid card as a gift for another person. Whether the exclusion applies generally does not depend on the type of entity that makes the promotional message. For example, a card may be marketed or labeled as a gift card or gift certificate if anyone (other than the purchaser of the card), including the issuer, the retailer, the program manager that may distribute the card, or the payment network on which a card is used, promotes the use of the card as a gift card or gift certificate. A general-use prepaid card is marketed or labeled as a gift card or gift certificate even if it is only occasionally marketed as a gift card or gift certificate. For example, a network-branded general purpose reloadable card would be marketed or labeled as a gift card or gift certificate if the issuer principally advertises the card as a less costly alternative to a bank account but promotes the card in a television, radio, newspaper, or Internet advertisement, or on signage as ''the perfect gift'' during the holiday season.

ii. The mere mention of the availability of gift cards or gift certificates in an advertisement or on a sign that also indicates the availability of exempted general-use prepaid cards does not by itself cause the general-use prepaid card to be marketed as a gift card or a gift certificate. For example, the posting of a sign in a store that refers to the availability of gift cards does not by itself constitute the marketing of otherwise exempted general-use prepaid cards that may also be sold in the store along with gift cards or gift certificates, provided that a person acting reasonably under the circumstances would not be led to believe that the sign applies to all cards sold in the store. (*See, however,* comment 5(c)–4.ii.)

4. *Examples of marketed or labeled as a gift card or gift certificate.*

i. The following are examples of marketed or labeled as a gift card or gift certificate:

A. Using the word ''gift'' or ''present'' on a card or accompanying material, including documentation, packaging and promotional displays;

B. Representing or suggesting that a card can be given to another person, for example, as a "token of appreciation" or a "stocking stuffer," or displaying a congratulatory message on the card or accompanying material;

C. Incorporating gift-giving or celebratory imagery or motifs, such as a bow, ribbon, wrapped present, candle, or a holiday or congratulatory message, on a card, accompanying documentation, or promotional material;

ii. The term does not include the following:

A. Representing that a card can be used as a substitute for a checking, savings, or deposit account;

B. Representing that a card can be used to pay for a consumer's health-related expenses—for example, a card tied to a health savings account;

C. Representing that a card can be used as a substitute for travelers checks or cash;

D. Representing that a card can be used as a budgetary tool, for example, by teenagers, or to cover emergency expenses.

5. *Reasonable policies and procedures to avoid marketing as a gift card.* The exemption for a general-use prepaid card that is reloadable and not marketed or labeled as a gift card or gift certificate in §235.5(c) applies if a reloadable general-use prepaid card is not marketed or labeled as a gift card or gift certificate and if persons involved in the distribution or sale of the card, including issuers, program managers, and retailers, maintain policies and procedures reasonably designed to avoid such marketing. Such policies and procedures may include contractual provisions prohibiting a reloadable general-use prepaid card from being marketed or labeled as a gift card or gift certificate, merchandising guidelines or plans regarding how the product must be displayed in a retail outlet, and controls to regularly monitor or otherwise verify that the general-use prepaid card is not being marketed as a gift card. Whether a general-use prepaid card has been marketed as a gift card or gift certificate will depend on the facts and circumstances, including whether a reasonable person would be led to believe that the general-use prepaid card is a gift card or gift certificate. The following examples illustrate the application of §235.5(c):

i. An issuer or program manager of prepaid cards agrees to sell general-purpose reloadable cards through a retailer. The contract between the issuer or program manager and the retailer establishes the terms and conditions under which the cards may be sold and marketed at the retailer. The terms and conditions prohibit the general-purpose reloadable cards from being marketed as a gift card or gift certificate, and require policies and procedures to regularly monitor or otherwise verify that the cards are not being marketed as such. The issuer or program manager sets up one promotional display at the retailer for gift cards and another physically separated display for exempted products under §235.5(c), including general-purpose reloadable cards, such that a reasonable person would not believe that the exempted cards are gift cards. The exemption in §235.5(c) applies because policies and procedures reasonably designed to avoid the marketing of the general-purpose reloadable cards as gift cards or gift certificates are maintained, even if a retail clerk inadvertently stocks or a consumer inadvertently places a general-purpose reloadable card on the gift card display.

ii. Same facts as in comment 5(c)–5.i, except that the issuer or program manager sets up a single promotional display at the retailer on which a variety of prepaid cards are sold, including store gift cards and general-purpose reloadable cards. A sign stating "Gift Cards" appears prominently at the top of the display. The exemption in §235.5(c) does not apply with respect to the general-purpose reloadable cards because policies and procedures reasonably designed to avoid the marketing of exempted cards as gift cards or gift certificates are not maintained.

iii. Same facts as in comment 5(c)–5.i, except that the issuer or program manager sets up a single promotional multi-sided display at the retailer on which a variety of prepaid card products, including store gift cards and general-purpose reloadable cards are sold. Gift cards are segregated from exempted cards, with gift cards on one side of the display and exempted cards on a different side of a display. Signs of equal prominence at the top of each side of the display clearly differentiate between gift cards and the other types of prepaid cards that are available for sale. The retailer does not use any more conspicuous signage suggesting the general availability of gift cards, such as a large sign stating "Gift Cards" at the top of the display or located near the display. The exemption in §235.5(c) applies because policies and procedures reasonably designed to avoid the marketing of the general-purpose reloadable cards as gift cards or gift certificates are maintained, even if a retail clerk inadvertently stocks or a consumer inadvertently places a general-purpose reloadable card on the gift card display.

iv. Same facts as in comment 5(c)–5.i, except that the retailer sells a variety of prepaid card products, including store gift cards and general-purpose reloadable cards, arranged side-by-side in the same checkout lane. The retailer does not affirmatively indicate or represent that gift cards are available, such as by displaying any signage or other indicia at the checkout lane suggesting the general availability of gift cards. The exemption in §235.5(c) applies because policies and procedures reasonably designed to avoid marketing the general-purpose

reloadable cards as gift cards or gift certificates are maintained.

6. *On-line sales of prepaid cards.* Some web sites may prominently advertise or promote the availability of gift cards or gift certificates in a manner that suggests to a consumer that the web site exclusively sells gift cards or gift certificates. For example, a web site may display a banner advertisement or a graphic on the home page that prominently states "Gift Cards," "Gift Giving," or similar language without mention of other available products, or use a web address that includes only a reference to gift cards or gift certificates in the address. In such a case, a consumer acting reasonably under the circumstances could be led to believe that all prepaid products sold on the web site are gift cards or gift certificates. Under these facts, the web site has marketed all such products as gift cards or gift certificates, and the exemption in §235.5(c) does not apply to any products sold on the web site.

7. *Temporary non-reloadable cards issued in connection with a general-use reloadable card.* Certain general-purpose prepaid cards that are typically marketed as an account substitute initially may be sold or issued in the form of a temporary non-reloadable card. After the card is purchased, the cardholder is typically required to call the issuer to register the card and to provide identifying information in order to obtain a reloadable replacement card. In most cases, the temporary non-reloadable card can be used for purchases until the replacement reloadable card arrives and is activated by the cardholder. Because the temporary non-reloadable card may only be obtained in connection with the reloadable card, the exemption in §235.5(c) applies so long as the card is not marketed as a gift card or gift certificate.

5(d) Exception

1. *Additional ATM access.* Some debit cards may be used to withdraw cash from ATMs that are not part of the issuer's designated ATM network. An electronic debit card transaction may still qualify for the exemption under §§235.5(b) or (c) with a respect to a card for which a fee may be imposed for a withdrawal from an ATM that is outside of the issuer's designated ATM network as long as the card complies with the condition set forth in §235.5(d)(2) for withdrawals within the issuer's designated ATM network. The condition with respect to ATM fees does not apply to cards that do not provide ATM access.

SECTION 235.6 PROHIBITION ON CIRCUMVENTION, EVASION, AND NET COMPENSATION

1. *No applicability to exempt issuers or electronic debit transactions.* The prohibition against circumventing or evading the interchange transaction fee restrictions or against net compensation does not apply to issuers or electronic debit transactions that qualify for an exemption under §235.5 from the interchange transaction fee restrictions.

6(a) Prohibition of Circumvention or Evasion

1. *Finding of circumvention or evasion.* A finding of evasion or circumvention will depend on all relevant facts and circumstances. Although net compensation may be one form of circumvention or evasion prohibited under §235.6(a), it is not the only form.

2. *Examples of circumstances that may constitute circumvention or evasion.*

The following examples do not constitute per se circumvention or evasion, but may warrant additional supervisory scrutiny to determine whether the totality of the facts and circumstances constitute circumvention or evasion:

i. A payment card network decreases network processing fees paid by issuers for electronic debit transactions by 50 percent and increases the network processing fees charged to merchants or acquirers with respect to electronic debit transactions by a similar amount. Because the requirements of this subpart do not restrict or otherwise establish the amount of fees that a network may charge for its services, the increase in network fees charged to merchants or acquirers and decrease in fees charged to issuers is not a per se circumvention or evasion of the interchange transaction fee standards, but may warrant additional supervisory scrutiny to determine whether the facts and circumstances constitute circumvention or evasion.

ii. An issuer replaces its debit cards with prepaid cards that are exempt from the interchange limits of §§235.3 and 235.4. The exempt prepaid cards are linked to its customers' transaction accounts and funds are swept from the transaction accounts to the prepaid accounts as needed to cover transactions made. Again, this arrangement is not per se circumvention or evasion, but may warrant additional supervisory scrutiny to determine whether the facts and circumstances constitute circumvention or evasion.

6(b) Prohibition of Net Compensation

1. *Net compensation.* Net compensation to an issuer through the use of network fees is prohibited.

2. *Consideration of payments or incentives provided by the network in net compensation determination.*

i. For purposes of the net compensation determination, payments or incentives paid by a payment card network to an issuer with respect to electronic debit transactions or debit card related activities could include, but are not limited to, marketing incentives;

payments or rebates for meeting or exceeding a specific transaction volume, percentage share, or dollar amount of transactions processed; or other payments for debit card related activities. For example, signing bonuses paid by a network to an issuer for the issuer's debit card portfolio would also be included in the total amount of payments or incentives received by an issuer from a payment card network with respect to electronic debit transactions. A signing bonus for an entire card portfolio, including credit cards, may be allocated to the issuer's debit card business based on the proportion of the cards or transactions that are debit cards or electronic debit transactions, as appropriate to the situation, for purposes of the net compensation determination.

ii. Incentives paid by the network with respect to multiple-year contracts may be allocated over the life of the contract.

iii. For purposes of the net compensation determination, payments or incentives paid by a payment card network with respect to electronic debit transactions or debit card-related activities do not include interchange transaction fees that are passed through to the issuer by the network, or discounts or rebates provided by the network or an affiliate of the network for issuer-processor services. In addition, funds received by an issuer from a payment card network as a result of chargebacks, fines paid by merchants or acquirers for violations of network rules, or settlements or recoveries from merchants or acquirers to offset the costs of fraudulent transactions or a data security breach do not constitute incentives or payments made by a payment card network.

3. *Consideration of fees paid by an issuer in net compensation determination.*

i. For purposes of the net compensation determination, fees paid by an issuer to a payment card network with respect to electronic debit transactions or debit card related activities include, but are not limited to, membership or licensing fees, network administration fees, and fees for optional network services, such as risk management services.

ii. For purposes of the net compensation determination, fees paid by an issuer to a payment card network with respect to electronic debit transactions or debit card-related activities do not include network processing fees (such as switch fees and network connectivity fees) or fees paid to an issuer processor affiliated with the network for authorizing, clearing, or settling an electronic debit transaction.

4. *Example of circumstances not involving net compensation to the issuer.* The following example illustrates circumstances that would not indicate net compensation by the payment card network to the issuer:

i. Because of an increase in debit card transactions that are processed through a payment card network during a calendar year, an issuer receives an additional volume-based incentive payment from the network for that period. Over the same period, however, the total network fees (other than processing fees) the issuer pays the payment card network with respect to debit card transactions also increase so that the total amount of fees paid by the issuer to the network continue to exceed incentive payments by the network to the issuer. Under these circumstances, the issuer does not receive net compensation from the network for electronic debit transactions or debit card related activities.

SECTION 235.7 LIMITATIONS ON PAYMENT CARD RESTRICTIONS

1. *Application of small issuer, government-administered payment program, and reloadable card exemptions to payment card network restrictions.* The exemptions under §235.5 for small issuers, cards issued pursuant to government-administered payment programs, and certain reloadable prepaid cards do not apply to the limitations on payment card network restrictions. For example, debit cards for government-administered payment programs, although exempt from the restrictions on interchange transaction fees, are subject to the requirement that electronic debit transactions made using such cards must be capable of being processed on at least two unaffiliated payment card networks and to the prohibition on inhibiting a merchant's ability to determine the routing for electronic debit transactions.

7(a) Prohibition on Network Exclusivity

1. *Scope of restriction.* Section 235.7(a) requires a debit card subject to the regulation to be enabled on at least two unaffiliated payment card networks. This paragraph does not, however, require an issuer to have two or more unaffiliated networks available for each method of cardholder authentication. For example, it is sufficient for an issuer to issue a debit card that operates on one signature-based card network and on one PIN-based card network, as long as the two card networks are not affiliated. Alternatively, an issuer may issue a debit card that is accepted on two unaffiliated signature-based card networks or on two unaffiliated PIN-based card networks. *See also*, comment 7(a)–7.

2. *Permitted networks.* i. A smaller payment card network could be used to help satisfy the requirement that an issuer enable two unaffiliated networks if the network was willing to expand its coverage in response to increased merchant demand for access to its network and it meets the other requirements for a permitted arrangement, including taking steps reasonably designed to enable it to process the electronic debit transactions

that it would reasonably expect to be routed to it. If, however, the network's policy or practice is to limit such expansion, it would not qualify as one of the two unaffiliated networks.

ii. A payment card network that is accepted only at a limited category of merchants (such as a particular grocery store chain, merchants located in a particular shopping mall, or a single class of merchants, such as grocery stores or gas stations) would not satisfy the rule.

iii. One of the steps a network can take to form a reasonable expectation of transaction volume is to consider factors such as the number of cards expected to be issued that are enabled on the network and expected card usage patterns.

3. *Examples of prohibited network restrictions on an issuer's ability to contract.* The following are examples of prohibited network restrictions on an issuer's ability to contract with other payment card networks:

i. Network rules or contract provisions limiting or otherwise restricting the other payment card networks that may be enabled on a particular debit card, or network rules or contract provisions that specify the other networks that may be enabled on a particular debit card.

ii. Network rules or guidelines that allow only that network's (or its affiliated network's) brand, mark, or logo to be displayed on a particular debit card, or that otherwise limit the ability of brands, marks, or logos of other payment card networks to appear on the debit card.

4. *Network logos or symbols on card not required.* Section 235.7(a) does not require that a debit card display the brand, mark, or logo of each payment card network over which an electronic debit transaction may be processed. For example, this rule does not require a debit card that is enabled for two or more unaffiliated payment card networks to bear the brand, mark, or logo for each card network.

5. *Voluntary exclusivity arrangements prohibited.* Section 235.7(a) requires the issuance of debit cards that are enabled on at least two unaffiliated payment card networks, even if the issuer is not subject to any rule of, or contract or other agreement with, a payment card network requiring that all or a specified minimum percentage of electronic debit transactions be processed on the network or its affiliated networks.

6. *Affiliated payment card networks.* Section 235.7(a) does not prohibit an issuer from including an affiliated payment card network among the networks that may process an electronic debit transaction with respect to a particular debit card, as long as at least two of the networks that are enabled on the card are unaffiliated. For example, an issuer may offer debit cards that are accepted on a payment card network for signature debit transactions and on an affiliated payment card network for PIN debit transactions as long as those debit cards may also be accepted on another unaffiliated payment card network.

7. *Application of rule regardless of form factor.* The network exclusivity provisions in §235.7(a) require that all debit cards be enabled on at least two unaffiliated payment card networks for electronic debit transactions, regardless of whether the debit card is issued in card form. This applies to any supplemental device, such as a fob or token, or chip or application in a mobile phone, that is issued in connection with a plastic card, even if that plastic card fully complies with the rule.

7(b) Prohibition on Routing Restrictions

1. *Relationship to the network exclusivity restrictions.* An issuer or payment card network is prohibited from inhibiting a merchant's ability to route or direct an electronic debit transaction over any of the payment card networks that the issuer has enabled to process an electronic debit transaction for that particular debit card. This rule does not permit a merchant to route the transaction over a network that the issuer did not enable to process transactions using that debit card.

2. *Examples of prohibited merchant restrictions.* The following are examples of issuer or network practices that would inhibit a merchant's ability to direct the routing of an electronic debit transaction that are prohibited under §235.7(b):

i. Prohibiting a merchant from encouraging or discouraging a cardholder's use of a particular method of debit card authorization, such as rules prohibiting merchants from favoring a cardholder's use of PIN debit over signature debit, or from discouraging the cardholder's use of signature debit.

ii. Establishing network rules or designating issuer priorities directing the processing of an electronic debit transaction on a specified payment card network or its affiliated networks, or directing the processing of the transaction away from a specified network or its affiliates, except as a default rule in the event the merchant, or its acquirer or processor, does not designate a routing preference, or if required by state law.

iii. Requiring a specific payment card network based on the type of access device provided to the cardholder by the issuer.

3. *Merchant payments not prohibited.* A payment card network does not restrict a merchant's ability to route transactions over available payment card networks in violation of §235.7(b) by offering payments or other incentives to encourage the merchant to route electronic debit card transactions to the network for processing.

4. *Real-time routing decision not required.* A merchant need not make network routing

decisions on a transaction-by-transaction basis. A merchant and its acquirer or processor may agree to a pre-determined set of routing choices that apply to all electronic debit transactions that are processed by the acquirer or processor on behalf of the merchant.

5. *No effect on network rules governing the routing of subsequent transactions.* Section 235.7 does not supersede a network rule that requires a chargeback or return of an electronic debit transaction to be processed on the same network that processed the original transaction.

7(c) Effective Date

1. *Health care and employee benefit cards.* Section 235.7(c)(1) delays the effective date of the network exclusivity provisions for certain debit cards issued in connection with a health care or employee benefit account to the extent such cards use (even if not required) transaction substantiation or qualification authorization systems at point of sale to verify that the card is only used for eligible goods and services for purposes of qualifying for favorable tax treatment under Internal Revenue Code requirements. Debit cards that may qualify for the delayed effective date include, but may not be limited to, cards issued in connection with flexible spending accounts established under section 125 of the Internal Revenue Code for health care related expenses and health reimbursement accounts established under section 105 of the Internal Revenue Code.

SECTION 235.8 REPORTING REQUIREMENTS AND RECORD RETENTION

[Reserved]

SECTION 235.9 ADMINISTRATIVE ENFORCEMENT

[Reserved]

SECTION 235.10 EFFECTIVE AND COMPLIANCE DATES

[Reserved]

[76 FR 43466, July 20, 2011, as amended at 76 FR 43467, July 20, 2011; 77 FR 46280, Aug. 3, 2012]