IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF KENTUCKY
FRANKFORT DIVISION

LINNEY'S PIZZA, LLC,

Plaintiff,

v. Case No. 3:22-cv-00071-GFVT

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Defendant.

BRIEF OF *AMICI CURIAE* RETAIL LITIGATION CENTER, INC., NATIONAL FEDERATION OF INDEPENDENT BUSINESS SMALL BUSINESS LEGAL CENTER, INC., AND MERCHANT ADVISORY GROUP IN SUPPORT OF PLAINTIFF LINNEY'S PIZZA, LLC'S MOTION FOR SUMMARY JUDGMENT

Deborah R. White
Larissa M. Whittingham
RETAIL LITIGATION CENTER, INC.
99 M Street, S.E., Suite 700
Washington, DC 2003
(202) 869-0200
deborah.white@rila.org

Michael P. Abate
KAPLAN JOHNSON ABATE & BIRD
710 West Main Street, 4th Floor
Louisville, KY 40202
(502) 540-8280 (Telephone)
mabate@kaplanjohnsonlaw.com

Adam G. Unikowsky
JENNER & BLOCK LLP
1099 New York Ave. N.W. Suite 900
Washington, DC 20001-4412
(202) 639-6000
aunikowsky@jenner.com

Counsel for Amici Curiae *Retail Litigation Center, Inc. National Federation of Independent Business Small Business Legal Center, Inc., and Merchant Advisory Group*

CORPORATE DISCLOSURE STATEMENT

Retail Litigation Center, Inc., has no parent corporation and no publicly held company has 10% or greater ownership in Retail Litigation Center, Inc.

National Federation of Independent Business Small Business Legal Center, Inc. is a 501(c)(3) public interest law firm and is affiliated with the National Federation of Independent Business, Inc. a 501(c)(6) business association. The National Federation of Independent Business, Inc. has no parent corporation and no publicly held corporation owns 10% or more of its stock.

Merchant Advisory Group has no parent corporation and no publicly held company has 10% or greater ownership in Merchant Advisory Group.

No publicly held corporation or its affiliate that is not a party to this case or appearing as *amicus curiae* has a substantial financial interest in the outcome of this litigation by reason of insurance, a franchise agreement, or an indemnity agreement.

TABLE OF CONTENTS

CORPORATE DISCLOSURE STATEMENT i

TABLE OF AUTHORITIES iii

INTEREST OF *AMICI CURIAE* 1

INTRODUCTION AND SUMMARY OF ARGUMENT 3

ARGUMENT 4

I. THE INCLUSION OF THE PROHIBITED COSTS IN REGULATION II'S FEE CAP CANNOT BE SQUARED WITH THE TEXT OR PURPOSE OF THE DURBIN AMENDMENT. 4

A. The Inclusion of the Prohibited Costs in the Fee Cap Established by Regulation II Clearly Exceeds the Board's Authority Under the Plain Text of the Durbin Amendment. 4

B. The Broader Statutory and Regulatory Context Confirms that the Board Has Exceeded its Statutory Authority 7

II. THE INCLUSION OF THE PROHIBITED COSTS IN REGULATION II'S FEE CAP IMPOSES MASSIVE AND IMPROPER COSTS ON RETAILERS AND OTHER MERCHANTS. 9

A. Regulation II Has Permitted Banks To Extract Massive Profits from Retailers, and These Profits Are Increasing. 9

B. Regulation II's Inclusion of the Prohibited Costs Has Also Effectively Forced Merchants To Indemnify Issuers for Fraud Losses. 13

III. THE BANKS' POLICY JUSTIFICATIONS FOR INCLUDING THE PROHIBITED COSTS LACK MERIT. 15

CONCLUSION 18

TABLE OF AUTHORITIES

CASES

Chewy, Inc. v. United States Department of Labor, 69 F.4th 773 (11th Cir. 2023)..... 1

Kirtsaeng v. John Wiley & Sons, Inc., 568 U.S. 519 (2013)..... 1

Loper Bright Enterprises v. Raimondo, 144 S. Ct. 2244 (2024)..... 5

NACS v. Board of Governors of Federal Reserve System, 746 F.3d 474 (D.C. Cir. 2014)..... 4, 5, 9

Pulse Network LLC v. Visa, Inc., 30 F.4th 480 (5th Cir. 2022)..... 16

South Dakota v. Wayfair, Inc., 585 U.S. 162 (2018)..... 1

State v. Welch, 595 S.W.3d 615 (Tenn. 2020)..... 1

STATUTES

15 U.S.C. § 1693*o*-2..... 3, 8

15 U.S.C. § 1693*o*-2(a)(1)..... 17

15 U.S.C. § 1693*o*-2(a)(2)..... 8, 17

15 U.S.C. § 1693*o*-2(a)(3)(A)..... 3

15 U.S.C. § 1693*o*-2(a)(4)(A)..... 6-7, 10, 17

15 U.S.C. § 1693*o*-2(a)(4)(B)(i)..... 5, 13

15 U.S.C. § 1693*o*-2(a)(4)(B)(ii)..... 5, 17

15 U.S.C. § 1693*o*-2(a)(5)(A)..... 6

15 U.S.C. § 1693*o*-2(a)(5)(A)(ii)(I)..... 6

15 U.S.C. § 1693*o*-2(a)(5)(B)(ii)(IV)..... 15

15 U.S.C. § 1693*o*-2(a)(5)(B)(ii)(V)..... 15

15 U.S.C. § 1693*o*-2(a)(8)(B)(i)..... 6

15 U.S.C. § 1693*o*-2(c)(10)..... 5-6

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010)..... 7-8

LEGISLATIVE MATERIALS

156 Cong. Rec. 10,441 (2010) (statement of Sen. Durbin) 6

OTHER AUTHORITIES

Terri Bradford, *Developments in Interchange Fees in the United States and Abroad*, Payments Sys. Rsch. Briefing (Federal Reserve Bank of Kansas City Apr. 2008), https://www.kansascityfed.org/documents/695/briefings-psr-briefingapr08.pdf 7

Board of Governors of the Federal Reserve System, *2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions* (Oct. 2023), https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2021.pdf 12, 13

Brief of Amicus Curiae United States Senator Richard J. Durbin in Support of Plaintiffs-Appellees, *NACS v. Board of Governors of the Federal Reserve System*, No. 13-5270 (D.C. Cir. Nov. 20, 2013), 2013 WL 6115708 8

Comments of 7-Eleven, Inc. ("SEI"), Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 10, 2024) 15

Comments of Merchant Advisory Group, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 12, 2024) 10, 12, 15

Comments of National Retail Federation, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 12, 2024) 15

Comments of Retail Industry Leaders Ass'n, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 10, 2024) 12, 14, 18

Comments of Target, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 12, 2024) 11, 15

Comments of Walgreens, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 9, 2024) 11

Complaint, *United States v. Visa, Inc.*, No. 24-cv-7214 (S.D.N.Y. Sept. 24, 2024), ECF No. 1 ..... 10, 16

Debit Card Interchange Fees and Routing, Final Rule, 76 Fed. Reg. 43,394 (July 20, 2011) 4

Debit Card Interchange Fees and Routing, Notice of Proposed Rulemaking, 75 Fed. Reg. 81,722 (Dec. 28, 2010) 8

Debit Card Interchange Fees and Routing, Notice of Proposed Rulemaking, 88 Fed. Reg. 78,100 (Nov. 14, 2023) 10, 11, 13, 14, 15

Renee Haltom & Zhu Wang, *Did the Durbin Amendment Reduce Merchant Costs? Evidence from Survey Results*, Federal Reserve Bank of Richmond, Economic Brief (Dec. 2015), https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2015/pdf/eb_15-12.pdf 9

Letter from James W. Frost, Office of Policy & Coordination, Bureau of Competition, FTC, to Julie B. Rottenberg, Deputy General Counsel, Chief Counsel, North America, Risk and Merchant Solutions Visa Inc. (Nov. 22, 2016), https://www.ftc.gov/system/files/documents/closing_letters/nid/closing_letter_from_james_frost_to_visa_-_11-22-16.pdf 16

Mastercard Net Profit Margin 2010-2024 | MA, Macrotrends (data as of Sept. 30, 2024), https://www.macrotrends.net/stocks/charts/MA/mastercard/net-profit-margin 10

Vladimir Mukharlyamov & Natasha Sarin, *The Impact of the Durbin Amendment on Banks, Merchants, and Consumers* (Univ. of Pa. Law Sch., Faculty Scholarship, Paper No. 2046, 2019), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3048&context=faculty_scholarship 7

New York University, *Margins by Sector (US)* (data as of Jan. 2024), https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html 10, 11

Press Release, American Bankers Ass'n, *ABA Statement on Federal Reserve's Proposed Regulation II Changes* (Oct. 25, 2023), https://www.aba.com/about-us/press-room/press-releases/federal-reserve-proposed-regulation-ii-changes 17

Press Release, FTC, *FTC Approves Final Order Requiring Mastercard to Stop Blocking the Use of Competing Debit Payment Networks* (May 30, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/05/ftc-approves-final-order-requiring-mastercard-stop-blocking-use-competing-debit-payment-networks 16

Reuters, *Visa, Mastercard Draw FTC Inquiry Over Debit Card Transactions - Bloomberg Law*, Reuters (Nov. 13, 2019), https://www.reuters.com/article/us-ftc-visa-mastercard-probe/visa-mastercard-draw-ftc-inquiryover-debit-card-transactions-bloomberg-law-idUSKBN1XN291 16

Visa Net Profit Margin 2010-2024 | V, Macrotrends (data as of Sept. 30, 2024), https://www.macrotrends.net/stocks/charts/V/visa/net-profit-margin 10

INTEREST OF *AMICI CURIAE*[1]

The Retail Litigation Center, Inc. ("RLC") is a 501(c)(6) nonprofit trade association that represents national and regional retailers, including many of the country's largest and most innovative retailers, across a breadth of retail verticals. The RLC is the only trade association solely dedicated to representing the retail industry in the courts. The RLC's members employ millions of people throughout the United States, provide goods and services to tens of millions more, and account for tens of billions of dollars in annual sales. The RLC offers retail-industry perspectives to courts on important legal issues and highlights the industry-wide consequences of significant cases. Since its founding in 2010, the RLC has filed more than 250 amicus briefs on issues of importance to the retail industry. Its amicus briefs have been helpful to courts across the United States, as evidenced by citation to RLC amicus briefs in numerous precedential opinions. *See, e.g., South Dakota v. Wayfair, Inc.*, 585 U.S. 162, 184 (2018); *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519, 542 (2013); *Chewy, Inc. v. U.S. Dep't of Lab.*, 69 F.4th 773, 777–78 (11th Cir. 2023); *State v. Welch*, 595 S.W.3d 615, 630 (Tenn. 2020).

The National Federation of Independent Business Small Business Legal Center, Inc. ("NFIB Legal Center") is a nonprofit, public interest law firm established to provide legal resources and be the voice for small businesses in the nation's courts through representation on issues of public interest affecting small businesses. NFIB Legal Center is an affiliate of the National Federation of Independent Business, Inc. ("NFIB"), which is the nation's leading small business association. NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses. NFIB represents, in Washington, D.C., and all 50 state capitals,

[1] All parties consented to the filing of this brief. No party's counsel authored this brief in whole or in part; no party or party's counsel contributed money to fund the preparation or submission of this brief; and no other person except *amici curiae* contributed money to fund the preparation or submission of this brief.

the interests of its members.

The Merchant Advisory Group ("MAG") plays a critical role in shaping innovative approaches to payments by fostering unparalleled collaboration and networking opportunities for nearly 200 merchants, which account for over $4.8 trillion in annual sales at over 580,000 locations across the U.S. and online. MAG members employ over 14 million associates. Through its engagement with diverse stakeholders, MAG advocates for merchants' interests, driving meaningful change across the payments landscape.

Collectively, *amici* represent a broad range of merchants—from single-store operators to major U.S. retailers—who have a strong interest in the important issues raised by this case. Regulation II, the challenged regulation at issue, governs billions of debit transactions that occur each year at *amici*'s member businesses. These members are retailers and merchants of all sizes. Because the Regulation II debit interchange fee cap inappropriately encompasses costs that Congress did not authorize the Federal Reserve Board (the "Board") to include, *amici*'s members have been forced to pay issuers inflated fees for more than a decade. In aggregate, it is estimated that merchants have paid issuers *$73 billion* in excess profits between 2011, when the Board promulgated Regulation II, and 2021 (the most recent year for which data is available). *Amici* previously filed an amicus brief in other litigation challenging Regulation II. *See* ECF No. 53, *Corner Post, Inc. v. Board of Governors of the Federal Reserve System*, No. 1:21-cv-00095 (D.ND. filed Nov. 25, 2024). *Amici* file a brief in this case to help the court understand why the inclusion of certain costs in calculating the Regulation II fee standard exceeds the Board's statutory authority; how the inclusion of these prohibited fees in Regulation II's cap adversely impacted retailers; and why issuers' policy defenses of this component of Regulation II cannot adequately justify the unlawfully excessive rate.

INTRODUCTION AND SUMMARY OF ARGUMENT

The Court should grant Linney's Pizza LLC's motion for summary judgment. *See* ECF No. 39. Congress made its intention plain in the Durbin Amendment to the Dodd-Frank Wall Street Reform Act (the "Durbin Amendment"), 15. U.S.C. § 1693*o*-2: large issuer-banks should not profit from debit interchange fees, and should instead only charge what is "reasonable and proportional to the cost incurred by the issuer with respect to the transaction," *id.* § 1693*o*-2(a)(3)(A). The Durbin Amendment delegated limited authority to the Board to "prescribe regulations" ensuring that this objective was met within parameters explicitly set out in the statute, including which costs may be included in any interchange transaction fee. The Board purported to fulfill this mandate in Regulation II. However, the cap set in Regulation II includes categories of costs that Congress expressly excluded.

The following types of costs were included in the final Regulation II rule despite falling within the "other costs" not allowed to be considered in the statute: "(1) fixed ACS costs, (2) transaction-monitoring costs, (3) network processing fees, and (4) a fraud-loss adjustment based on the value of the transaction" (collectively, the "Prohibited Costs"). ECF No. 39-1, at 9. Regulation II has thereby permitted issuers to extract massive profits from retailers and other merchants. The scale of these profits in the thirteen years since the Board promulgated Regulation II is staggering: issuers have taken $73 billion in excess profits from merchants during this period, including nearly $10 billion in 2021 alone. High-volume issuers are estimated to achieve profit margins approaching 600% under Regulation II. And these profits are likely to continue skyrocketing as issuers' costs decrease and consumers' debit card usage continues to surge.

This brief explains the impact the inclusion of the Prohibited Costs in Regulation II's fee cap has on retailers of all sizes. As *amici* explain and Congress understood, it is not appropriate

to force retailers and small businesses, who typically operate with razor-thin profit margins of 1-3%, to pay such exorbitant debit interchange fees while banks continue to enjoy profit margins of roughly 30%. Regulation II's inflated fee cap operates as nothing more than a vehicle to redistribute hard-earned money from businesses and consumers to wealthy banks. Because such a result is plainly foreclosed by Congress' mandate in the Durbin Amendment, the Court should grant Linney's Pizza's motion for summary judgment.

ARGUMENT

I. THE INCLUSION OF THE PROHIBITED COSTS IN REGULATION II'S FEE CAP CANNOT BE SQUARED WITH THE TEXT OR PURPOSE OF THE DURBIN AMENDMENT.

A. The Inclusion of the Prohibited Costs in the Fee Cap Established By Regulation II Clearly Exceeds the Board's Authority Under the Plain Text of the Durbin Amendment.

A debit interchange fee is the amount paid by a merchant to the bank that issued a consumer's debit card for each transaction in which the consumer uses that card to make a purchase. For card issuers with more than $10 billion in assets, Regulation II set a debit interchange fee cap of 21 cents per transaction, plus an *ad valorem* component of 0.05% of the transaction's value for fraud losses and a 1 cent "fraud-prevention adjustment" for debit-card issuers that meet certain fraud-prevention standards. In adopting this cap, in addition to the variable costs of authorization, clearance, and settlement ("ACS") that Congress directed the standard to address, the Federal Reserve Board included four additional types of costs: (1) fixed ACS costs; (2) transaction-monitoring costs; (3) network processing fees; and (4) fraud losses. *See generally Debit Card Interchange Fees and Routing*, Final Rule, 76 Fed. Reg. 43,394, 43,429-31, 43,404 (July 20, 2011); *NACS v. Bd. of Governors of Fed. Reserve Sys.*, 746 F.3d 474, 481 (D.C. Cir. 2014). The Board's inclusion of these four cost categories exceeds the statutory authority

Congress conferred on the Board when it enacted the Durbin Amendment, for several reasons.

First, Congress directed the Board to "distinguish between … the incremental costs incurred by an issuer" for its role in the "authorization, clearance, or settlement of a particular electronic debit transaction," which "shall be considered," and "other costs incurred by an issuer which are not specific to a particular electronic debit transaction," which "shall not be considered." 15 U.S.C. § 1693o-2(a)(4)(B)(i)-(ii). This statutory language can only be understood to mean that the universe of issuer costs is divided into two, mutually exclusive categories; there is no in-between category of costs that the Board has discretion to consider as recoverable costs. Yet, in promulgating Regulation II, the Board created a third category out of whole cloth and included the Prohibited Costs on that basis. Because none of the four types of Prohibited Costs is "specific to a particular electronic debit transaction," *id.* § 1693*o*-2(a)(4)(B)(ii), these costs do not fall within the category of costs Congress directed the Board to consider. Their inclusion in the debit interchange fee cap is therefore contrary to law.[2]

Second, Congress confirmed that the Prohibited Costs were not to be considered in calculating the interchange fee standard by addressing them elsewhere in the Durbin Amendment. For example, Congress defined interchange fees to exclude network-processing fees. *See id.* § 1693*o*-2(c)(10) ("network fee" defined as "any fee charged and received by a payment card network with respect to an electronic debit transaction, *other than an interchange transaction*

[2] The D.C. Circuit's decision in *NACS v. Board of Governors of Federal Reserve System*, 746 F.3d 474 (D.C. Cir. 2014), upholding the Board's authority to permit recovery of this third category of costs does not require a contrary result. The D.C. Circuit's decision is simply persuasive authority, not binding precedent on this Court. And, in fact, that decision has little persuasive value: the D.C. Circuit upheld Regulation II applying the now-overruled *Chevron* framework, and it concluded only that permitting the recovery of such in-between costs was a permissible reading under *Chevron* Step Two. *See id.* at 477, 484. The D.C. Circuit did not consider whether the Board's interpretation was correct under the *de novo* analysis that this Court must undertake. Under the *de novo* review required by *Loper Bright Enterprises v. Raimondo*, 144 S. Ct. 2244, 2273 (2024), the Board's interpretation fails.

fee"). Congress further mandated that the Board "ensure that … a network fee is not used to directly or indirectly compensate an issuer." *Id.* § 1693*o*-2(a)(8)(B)(i).

As for transaction-monitoring costs and fraud losses, Congress set forth a separate adjustment elsewhere in the statute to account for such fraud-related expenses—thereby making clear that the Board was to set the interchange fee standard *without* including these expenses. Thus, Congress specified that the "Board may allow for an adjustment to the fee amount received or charged by an issuer," but only if certain conditions were satisfied, most notably that the issuer must "compl[y] with the fraud-related standards established by the Board." *Id.* § 1693*o*-2(a)(5)(A); *id.* §1693*o*-2(a)(5)(A)(ii)(I). Congress' specification that the Board could *adjust* the interchange fee to account for fraud-prevention costs in certain circumstances makes clear that Congress did not intend for merchants to cover issuers' fraud-prevention costs as a *routine* component of the debit interchange fee. Along similar lines, Congress' specification of this fraud-prevention adjustment as the means to address debit-card fraud makes clear that the Board lacks authority to incorporate an across-the-board 5-basis-point allowance for fraud losses as a component of the interchange fee standard. The Board's reading of the statute renders superfluous this adjustment provision and removes any incentive for issuers to minimize debit-card fraud.[3]

Third, Congress made clear that the Board should view debit transactions as analogous to transactions made via personal check, which clear at par without any fees imposed by the customer's bank on the merchant who accepts the check. Thus, Congress directed the Board to "consider the functional similarity between (i) electronic debit transactions[] and (ii) checking transactions that are required within the Federal Reserve bank system to clear at par." *Id.* § 1693*o*-

[3] Indeed, Senator Durbin warned on the Senate floor that "[a]s long as big banks are guaranteed the same interchange revenue no matter how much or how little fraud they have, the banks have no incentive to keep fraud costs low." 156 Cong. Rec. 10,441 (2010) (statement of Sen. Durbin).

2(a)(4)(A). This mandatory obligation to consider the "functional similarity" between debit transactions and personal checks further confirms that Congress contemplated a system in which issuers were not permitted to take *any* profit at all with respect to debit transactions. *Id.* Yet by including Prohibited Costs in Regulation II, the Board created a regime that permits banks to extract massive profits via debit interchange fees, in contravention of the statute.

B. The Broader Statutory and Regulatory Context Confirms that the Board Has Exceeded its Statutory Authority.

The broader context of the Durbin Amendment's adoption reinforces what the plain text compels. Prior to the Durbin Amendment's enactment in 2010, debit interchange fees were not regulated and were set at exorbitant levels by card networks competing for a small number of large issuers' business.[4] Fees were typically set at a percentage of the transaction, an arrangement that made little sense given that the cost of "processing a $100 transaction should not be 100x the cost of processing a $1 transaction."[5] By the time of the 2008 recession, retailers' interchange expense (including the costs of processing both debit and credit cards), had become a "significant cost of operating for merchants, in some cases even their second highest cost after labor."[6]

Congress recognized that this situation gave debit-card issuers and card networks undue leverage over those who accepted debit cards, leading to excessive charges and supracompetitive profits. Congress responded with the Durbin Amendment. *See* Section 1075 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376, 2068-74

---

[4] One indication that these financial institutions were exploiting their market power to extract rents from merchants and consumers is that U.S. interchange fees during this period were much higher than in other nations. *See, e.g.*, Terri Bradford, *Developments in Interchange Fees in the United States and Abroad*, Payments Sys. Research Briefing (Federal Reserve Bank of Kansas City Apr. 2008), https://www.kansascityfed.org/documents/695/briefings-psr-briefingapr08.pdf.

[5] Vladimir Mukharlyamov & Natasha Sarin, *The Impact of the Durbin Amendment on Banks, Merchants, and Consumers* at 9 (Univ. of Pa. Law Sch., Faculty Scholarship, Paper No. 2046, 2019), https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=3048&context=faculty_scholarship.

[6] *Id.* at 8.

(2010), codified at 15 U.S.C. § 1693*o*-2. Senator Durbin explained that the Durbin Amendment aimed to "enhance competition, transparency and choice in the debit system and squeeze out inefficiencies by reducing … rates … thereby compelling large issuers to compete against each other to manage their other costs more efficiently."[7] Thus, the Durbin Amendment was intended to create a cost-recovery regime that would establish a standard for debit interchange fees at a level that reflected the banks' actual costs to process each transaction. *See, e.g.*, 15 U.S.C. § 1693*o*-2(a)(2) (interchange fee to be "reasonable and proportional to *the cost incurred by the issuer with respect to the transaction*"). Congress anticipated that this change would both increase competition and ensure prices at more competitive levels—i.e., levels that reflected marginal cost rather than market power.

Unfortunately, issuers successfully pressured the Board to distort Congress' direction to benefit their interests. The Board's *proposed* rule was more consistent with Congress' intent: it sought to impose a meaningful cap on debit interchange fees by proposing either a cap set at 7 cents per transaction (with an allowance for 12 cents in certain circumstances) or a 12-cent cap for all transactions. *See Debit Card Interchange Fees and Routing*, Notice of Proposed Rulemaking, 75 Fed. Reg. 81,722, 81,736-39 (Dec. 28, 2010). But ultimately the Board, with inappropriate concern for the impact on banks' revenue, "issued a Final Rule that almost doubled the proposed cap." *NACS*, 746 F.3d at 481. It did so by creating a third, extra-statutory category of costs, namely costs it deemed "specific to a particular transaction" that were not incremental to the card issuer's role in ACS. Thus, the banks were permitted to recover their ACS costs generally without regard to the statutory distinction between fixed and variable costs, as well as variable costs that were not tied to ACS at all. The impact of this unlawful regulation on retailers has been immense.

[7] Brief of United States Senator Richard J. Durbin in Support of Plaintiffs-Appellees at 18-19, *NACS v. Bd. of Governors of the Fed. Reserve Sys.*, No. 13-5270 (D.C. Cir. Nov. 20, 2013), 2013 WL 6115708.

II. THE INCLUSION OF THE PROHIBITED COSTS IN REGULATION II'S FEE CAP IMPOSES MASSIVE AND IMPROPER COSTS ON RETAILERS AND OTHER MERCHANTS.

From the moment it was promulgated, Regulation II has permitted issuing banks to earn massive, extra-statutory profits at the expense of all retailers that accept debit cards—from corner stores that pay the full interchange fee even for consumers who purchase a pack of gum—to major retailers that pay outsized fees on the full range of products that they sell. This situation has only grown more dire over the past decade, as the debit interchange fee base component has remained fixed at 21 cents while consumers' debit usage has exploded and issuers' average per-transaction ACS costs have been cut in half. At the same time, Regulation II has helped issuers shift fraud losses over to merchants, even as merchants have expended billions of dollars on anti-fraud technologies. The result is an intolerable situation for retailers, especially small entities like Linney's Pizza, who strive to keep customers' costs low but are increasingly squeezed by banks and card networks under Regulation II's unlawful and unfair interchange rate.

A. Regulation II Has Permitted Banks To Extract Massive Profits from Retailers, and These Profits Are Increasing.

Regulation II's interchange fee cap has permitted issuers to extract massive profits from retailers. The Durbin Amendment required the Federal Reserve Board establish a standard by which to determine a reasonable and proportional interchange fee and the Board did this by creating a cap. The card networks have successfully demanded interchange at no less than the cap, and there is no functioning market to drive interchange fees any lower than that level.[8] Crucially,

[8] Indeed, one consequence of Regulation II was increased costs for merchants with small-ticket transactions, who lost the discounted debit interchange fees that networks had offered prior to Regulation II to encourage those merchants to accept their cards. *See* Renee Haltom & Zhu Wang, *Did the Durbin Amendment Reduce Merchant Costs? Evidence from Survey Results*, Federal Reserve Bank of Richmond, Economic Brief at 2 (Dec. 2015), https://www.richmondfed.org/-/media/richmondfedorg/publications/research/economic_brief/2015/pdf/eb_15-12.pdf.

when the Board established the interchange fee base component of 21 cents in 2009, its own data showed that the transaction-weighted average of per-transaction base component costs across covered issuers was 7.7 cents.[9] In other words, Regulation II initially permitted recovery at a 2.7x multiplier. This base interchange rate of 270% of cost is equivalent to the Board setting a regulated net profit rate of 63% for issuers.[10] Such an extravagant profit margin is in direct conflict with the Durbin Amendment, which directed the Board to consider the functional similarities between debit cards and personal checks (where no transaction fees are collected at all despite the more labor-intensive process needed to process them). *See* 15 U.S.C. § 1693*o*-2(a)(4)(A).

Allowing banks to earn profits at this level is particularly unfair, and counter to the objective of the Durbin Amendment, because banks already operate with far larger profit margins than retailers do. Average bank profit margins are 29.67%.[11] Similarly, profit margins enjoyed by the two primary card networks, Visa and Mastercard, are roughly 50%.[12] According to the Department of Justice, Visa's operating margin in North America, of which U.S. debit is the largest contributor, was 83% in 2022.[13] By contrast, retailers of all sizes operate in highly competitive segments with low profit margins. For example, the profit margin for general retail is 3.09% and

[9] *Debit Card Interchange Fees and Routing*, Notice of Proposed Rulemaking, 88 Fed. Reg. 78,100, 78,105 (Nov. 14, 2023).
[10] Comments of Merchant Advisory Group at 7, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 12, 2024) ("MAG Comments").
[11] *See* New York University, *Margins by Sector (US)* (data as of Jan. 2024), https://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/margin.html ("New York University, *Margins by Sector (US)*") (showing Money Center Bank net profit margins at 30.89% and Regional Bank net profit margins at 29.67%).
[12] *See, e.g.*, *Visa Net Profit Margin 2010-2024 | V*, Macrotrends (data as of Sept. 30, 2024), https://www.macrotrends.net/stocks/charts/V/visa/net-profit-margin (Visa profit margin is 55%); *Mastercard Net Profit Margin 2010-2024 | MA*, Macrotrends (data as of Sept. 30, 2024), https://www.macrotrends.net/stocks/charts/MA/mastercard/net-profit-margin (Mastercard profit margin is 45%).
[13] Complaint at ¶¶ 63, 166, *United States v. Visa, Inc.*, No. 24-cv-7214 (S.D.N.Y. Sept. 24, 2024), ECF No. 1 ("Visa Complaint").

1.18% for grocery and food.[14] This redistribution from retailers to banks is unjustified and reflects a broken market in which duopoly stifles competition. Merchants accept global card networks due to business necessity, but they do not receive any benefit from higher interchange fees.

Retailers of all sizes have been impacted by these exorbitant fees. For example, small-ticket merchants like Walgreens, who operate on narrow profit margins, are greatly affected. Approximately 66% of Walgreens customers use debit cards when picking up prescriptions or making retail purchases.[15] Similarly, Target processes approximately 3 billion retail transactions each year, and its guests use debit cards more than any other form of payment.[16] The burden of high debit interchange fees is even more damning to the bottom line of small retail establishments. Ultimately, these costs must be borne by the entire retail ecosystem, including consumers.

The current burden on retailers and other merchants is even more extreme than the above figures suggest. The Board has recognized that issuers' actual costs have reduced from 7.7 cents to 3.9 cents between 2009 and 2021—a reduction of 49%.[17] While issuers' costs have been reduced by half, Regulation II's universal fee cap has remained in place at great cost to retailers. In addition, because the 21-cent cap is pegged to average costs, it has permitted high-volume issuers—who are able to take advantage of increased volume to significantly lower their per-transaction costs—to earn even more extravagant profits. High-volume issuer ACS costs per transaction were $0.035 by 2021, while mid-volume issuers' costs were 3 times as high ($0.109)

[14] *See* New York University, *Margins by Sector (US)*.
[15] Comments of Walgreens at 2, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 9, 2024).
[16] Comments of Target at 1, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 12, 2024) ("Target Comments").
[17] 88 Fed. Reg. at 78,105. Indeed, the Board has said it "believes it is necessary to revise the interchange fee standards to reflect the decline since 2009 in base component costs." *Id.*

and low-volume issuers' costs were 17 times as high ($0.595).[18] These high-volume issuers (roughly 50 banks) processed the vast majority of all regulated debit transactions by dollar value in 2021—approximately 94 percent. In 2021, such issuers had combined ACS costs of approximately $1.93 billion on an annual basis. Yet under Regulation II's inclusion of the Prohibited Costs in the cap calculation, they were permitted to charge $11.62 billion for the base component on these debit transactions. In other words, high-volume issuers currently enjoy excess profits of $9.69 billion per year—roughly a *600%* profit margin. Indeed, the three very largest issuers (Wells Fargo, Bank of America, and JP Morgan Chase) made up nearly 50% of all regulated spending and transactions in 2021. Because these entities likely have even lower costs, their per-transaction profit margin is almost certainly even higher still.[19]

Market trends suggest that retailers' situation will worsen. Debit usage continues to increase at high levels, with usage spiking during the pandemic as debit cards were increasingly used for online shopping. The Board found that 2021 saw nearly 20% growth in debit usage—the "largest observed since Regulation II came into effect."[20] This trend has continued, with U.S. general purpose debit volume for the Visa and Mastercard networks growing from $3.78 trillion in 2020 to $5.10 trillion in 2023.[21] Due to these forces, the scale of the transfer from retailers to big banks is staggering. Regulation II's base interchange fee has overcompensated issuers for their recoverable costs by roughly *$73 billion* from the time Regulation II was implemented through

[18] Board of Governors of the Federal Reserve System, *2021 Interchange Fee Revenue, Covered Issuer Costs, and Covered Issuer and Merchant Fraud Losses Related to Debit Card Transactions* at 25 (Oct. 2023), https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2021.pdf ("2021 Board Report").
[19] Comments of Retail Industry Leaders Ass'n at 15, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 10, 2024) ("RILA Comments").
[20] *Id.* at 2.
[21] *See* MAG Comments at 1 & n.3.

2021.[22] The Durbin Amendment was passed to prevent this result.

B. Regulation II's Inclusion of the Prohibited Costs Has Also Effectively Forced Merchants To Indemnify Issuers for Fraud Losses.

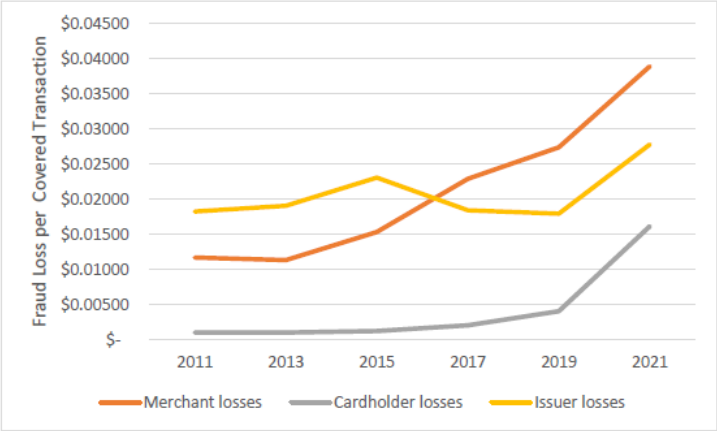
Regulation II further permits issuers to recover fraud losses from merchants via the *ad valorem* component of the debit interchange fee cap. This fraud reimbursement is not specific to "a particular debit transaction," as the statute requires. *Cf.* 15 U.S.C. § 1693*o*-2(a)(4)(B)(i). Moreover, this approach makes little sense: by shifting the burden of issuers' fraud losses onto merchants, issuers have no incentive to detect and eliminate fraud. But this impermissible cost has also been tremendously expensive for retailers and other merchants.

The reason is simple: covered issuers have taken advantage of Regulation II to impose the majority of fraud losses on retailers. They have done so by pocketing the Board's up-front award of an *ad valorem* component while benefiting from network rules that increasingly shift fraud losses onto merchants and consumers. In 2009, network rules allocated 61.2% of fraud losses on covered issuer transactions to issuers, 38.3% to merchants, and 0.5% to cardholders.[23] But, by 2021, those losses were borne 33.5% by issuers, 47% by merchants, and 19.5% by cardholders.[24] The Board itself noticed this trend: "Altogether, from 2011 to 2021, the percentage of losses from fraudulent transactions reported by covered issuers absorbed by merchants steadily increased from 38.3% to 47.0 percent, while the percentage of losses absorbed by issuers steadily decreased from 59.8 to 33.5 percent."[25] In other words, issuers are charging back 2/3 of fraud losses to merchants and cardholders, even though merchants (and ultimately consumers) are *already* paying the *ad valorem* fee on every covered transaction ostensibly to cover such fraud losses, as well as paying

[22] *Id.* at 5.
[23] 88 Fed. Reg. at 78,118.
[24] *Id.*; 2021 Board Report at 3.
[25] 2021 Board Report at 3.

for their own fraud prevention efforts. As the Board recently noted: "Since the Board adopted the interchange fee standards in 2011, the Board has observed an overall increase in fraud losses to all parties related to covered issuer transactions, but the share of such fraud losses absorbed by covered issuers (i.e., issuer fraud losses) has declined during that time."[26]

The chart below demonstrates the devastating effect on retailers of the policies issuers and networks have established.[27] As the chart shows, since 2011, issuer fraud losses have remained mostly stable. But beginning in 2013, merchant losses increased every year and nearly tripled in size. The same is true for cardholder losses, which grew steadily from 2011 to 2019, and then grew dramatically between 2019 and 2021. Today, issuers bear no more than 1/3 of the overall burden of debit card fraud, even though they are the parties best equipped to address it. Regulation II's *ad valorem* component continues to impose issuers' costs on everyone else in the system without recognizing that the cost of fraud is already higher for ratepayers than it is for the banks.



A further consequence of this state of affairs is that issuers are largely protected from the cost of fraud losses and therefore have no incentive to try to control it. Again, reality has borne that out. Over the past 13 years, the total fraud rate on covered debit transactions has more than

[26] 88 Fed. Reg. at 78,108.
[27] *See* RILA Comments at 28 (providing this chart).

doubled.[28] Yet the Board has still permitted issuers to collect the *ad valorem* component and, with minimal certification, to collect a per-transaction amount via the fraud-prevention adjustment.

Finally, the statute requires the Board to account for the "fraud prevention and data security costs expended by … retailers" and the "costs of fraudulent transactions absorbed by each party involved in such transactions," including "retailers." 15 U.S.C. § 1693*o*-2(a)(5)(B)(ii)(IV)-(V). But in practice, the Board has not done so, ignoring, for instance, the tens of billions of dollars in infrastructure investments since 2012 on EMV terminal technology. Indeed, merchants incurred the vast majority of costs associated with migrating the U.S. payment system to that more secure technology.[29] For example, 7-Eleven has spent hundreds of millions of dollars to upgrade or replace fuel pumps and in-store pin pad payment devices, as well as accompanying IT development costs.[30] Yet such expenditures have not reduced the debit interchange rates to which it and other retailers and small businesses are subject, including the fraud-related components.

In short, merchants today must reimburse issuers' entire share of fraud loss through the *ad valorem* interchange fee; pay the fraud prevention adjustment on every covered transaction, with minimal inquiry into whether the issuer actually has an effective fraud prevention system; and bear their own significant costs to implement additional fraud prevention measures.[31] In these respects as well, Regulation II imposes grossly disproportionate costs on retailers and small businesses.

III. THE BANKS' POLICY JUSTIFICATIONS FOR INCLUDING THE PROHIBITED COSTS LACK MERIT.

Issuers have suggested various rationales in support of Regulation II, but none is

[28] 88 Fed. Reg. at 78,118.
[29] MAG Comments at 10; Comments of National Retail Federation at 11, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 12, 2024) (estimating $30 billion in EMV costs).
[30] Comments of 7-Eleven, Inc. ("SEI") at 2-3, Docket No. R-1818 (Bd. of Governors of the Fed. Reserve Sys. May 10, 2024).
[31] Target Comments at 9.

persuasive. As an initial matter, some context is essential. Banks and card networks have consistently sought to take advantage of the Board's regulations to pad their bottom lines. The retail community has been compelled multiple times to request that the Federal Reserve and the Federal Trade Commission issue clarifications on routing requirements imposed by global networks attempting to circumvent the routing rules.[32] Thus, the Federal Trade Commission recently took action against Mastercard when it used a new technology to constrain merchants' ability to route transactions over competing networks.[33] And Visa was sued over new fees it implemented to frustrate dual routing and protect its market share (and high prices) from the competitive dynamics that the Durbin Amendment was intended to facilitate. *See Pulse Network LLC v. Visa, Inc.* 30 F.4th 480, 491-94 (5th Cir. 2022) (explaining how Visa's "Fixed Acquirer Network Fee" (or FANF) was used, after the Durbin Amendment, to protect Visa's debit market share while keeping total fees as high or higher than before).

Such efforts continue today. The Department of Justice recently sued Visa for violating the antitrust laws in the context of debit interchange fees.[34] And the banks have made clear that they are still using debit interchange to fund totally unrelated bank operations. Thus, the American Bankers Association warned in a statement issued after the Board's recent rulemaking announcement that the "proposal has the potential to make checking accounts, debit cards and *a*

---

[32] *See* Letter from James W. Frost, Office of Policy & Coordination, Bureau of Competition, FTC, to Julie B. Rottenberg, Deputy General Counsel, Chief Counsel, North America, Risk and Merchant Solutions Visa Inc. (Nov. 22, 2016), https://www.ftc.gov/system/files/documents/closing_letters/nid/closing_letter_from_james_frost_to_visa_-_11-22-16.pdf; *see generally* Reuters, *Visa, Mastercard Draw FTC Inquiry Over Debit Card Transactions - Bloomberg Law*, Reuters (Nov. 13, 2019), https://www.reuters.com/article/us-ftc-visa-mastercard-probe/visa-mastercard-draw-ftc-inquiryover-debit-card-transactions-bloomberg-law-idUSKBN1XN291.

[33] *See* Press Release, FTC, *FTC Approves Final Order Requiring Mastercard to Stop Blocking the Use of Competing Debit Payment Networks* (May 30, 2023), https://www.ftc.gov/news-events/news/press-releases/2023/05/ftc-approves-final-order-requiring-mastercard-stop-blocking-use-competing-debit-payment-networks.

[34] *See* Visa Complaint.

range of financial products more expensive for American consumers."[35] This practice flouts the statute, which is clear that debit interchange fees are meant only to cover the variable ACS costs of debit transactions.

In short, card networks and covered financial institutions have a track record of trying to evade regulation.[36] Understood in this context, the banks' policy justifications for including a range of costs not allowed by the Durbin Amendment in Regulation II's cap are not persuasive. For example, in seeking to intervene in this case, the Bank Policy Institute suggests that "[m]erchants in this two-sided market realize substantial benefits from debit card transactions (including increased business from consumers and a safer and guaranteed form of payment) and pay interchange fees to help cover the costs of maintaining the debit card payment system." ECF No. 26-1 at 2-3. But the statute plainly does not permit merchants to subsidize "the costs of maintaining the debit card payment system" writ large; to the contrary, the fee is to be pegged to the individual transaction—as the statute repeatedly makes clear. *See, e.g.*, 15 U.S.C. § 1693*o*-2(a)(2) (interchange fee to be "reasonable and proportional to *the cost incurred by the issuer with respect to the transaction*"); *id.* § 1693*o*-2(a)(4)(A) (requiring the Board to "consider the functional similarity" between "electronic debit transactions" and "checking transactions that are required … to clear at par"); *id.* § 1693*o*-2(a)(4)(B)(ii) (excluding consideration of "other costs incurred by [a bank] which are not specific to a particular electronic debit transaction").

In addition, the banks may suggest that smaller and less efficient debit programs may be harmed by a lower debit interchange fee cap, potentially causing them to exit the market altogether.

---

[35] Press Release, American Bankers Ass'n, *ABA Statement on Federal Reserve's Proposed Regulation II Changes* (Oct. 25, 2023), https://www.aba.com/about-us/press-room/press-releases/federal-reserve-proposed-regulation-ii-changes (emphasis added).

[36] Congress was well aware of this track record. The Durbin Amendment specifically authorized the Board to "prescribe regulations[] … to prevent the circumvention [of] or evasion of" the Durbin Amendment." 15 U.S.C. § 1693*o*-2(a)(1).

But the best data available indicate that this result is unlikely. The debit interchange cap does not apply to issuers under $10 billion in assets. For smaller covered issuers in the asset range of $10-$30 billion who report their gross debit interchange revenue, this revenue only represents 2.1% of their overall total. Further, for these same banks, their 2022 profit margin ranged from 20% to 35%, indicating healthy financial performance. In any event, concern about the consequences to the financial performance of the smallest issuers cannot justify a departure from the plain text of the Durbin Amendment, nor does it justify continuing to bestow windfalls on the largest issuers.[37]

Finally, banks may also argue that higher fees are needed to avoid an increase in cardholder fees or cuts to low- and no-cost basic banking services. But a reduction in debit interchange revenue need not be made up through additional cardholder fees or cuts to checking account features. Financial institutions have myriad sources of revenue, and enjoy net profit margins around 30%, meaning they are fully capable of continuing to offer debit programs and other account features and services even without collecting extra-statutory debit interchange fees to which they are not entitled and, indeed, that the statutory text prohibits them from collecting. Moreover, covered issuers that cut checking account features purportedly due to reductions in debit interchange revenue risk losing their customer base to other issuers, including the thousands of issuers who are not covered by Regulation II at all. Making such changes to the detriment of consumers would be a voluntary choice on the part of the banks, to be evaluated in the context of a competitive marketplace—not something compelled by financial necessity.

CONCLUSION

For the foregoing reasons, *amici curiae* respectfully urge this Court to grant Linney's Pizza's motion for summary judgment.

[37] *See generally* RILA Comments at 33.

Dated: February 26, 2025

Respectfully submitted,

/s/ Michael P. Abate

Deborah R. White
Larissa M. Whittingham
RETAIL LITIGATION CENTER, INC.
99 M Street SE Suite 700
Washington, DC 20003
(202) 869-0200
deborah.white@rila.org

Michael P. Abate
KAPLAN JOHNSON ABATE & BIRD
710 West Main Street, 4th Floor
Louisville, KY 40202
(502) 540-8280 (Telephone)
mabate@kaplanjohnsonlaw.com

Adam G. Unikowsky
JENNER & BLOCK LLP
1099 New York Ave. N.W. Suite 900
Washington, DC 20001-4412
(202) 639-6000
aunikowsky@jenner.com

Counsel for Amici Curiae *Retail Litigation Center, Inc., National Federation of Independent Business Small Business Legal Center, Inc., and Merchant Advisory Group*

CERTIFICATE OF SERVICE

I hereby certify that on February 26, 2025, I electronically filed the foregoing with the Clerk of Court using the CM/ECF system, which will send notification of such filing to all counsel of record.

/s/ Michael P. Abate