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Legal Sidebar

North Dakota Merchants Sue Fed, Claiming Debit Card Swipe Fees Exceed Those Allowed by the Durbin Amendment to the Electronic Funds Transfer Act

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On April 30, 2021, two North Dakota retail merchant associations sued the Board of Governors of the Federal Reserve System (Fed), claiming that the Fed's Regulation II authorizes debit card interchange (swipe) fees that violate the statutory standard requiring fees that are "reasonable and proportional" to bank costs in processing the transactions. In the case, *North Dakota Retail Association v. Board of Governors*, the plaintiffs assert that increased debit card use has meant "skyrocketing" interchange fee profits for banks and has left merchants no option but to accept debit cards and their high fees, especially when consumers avoid cash during the pandemic.

Under the Fed's rule, large banks may charge merchants swipe fees up to a cap of 21 cents for each debit card transaction, plus up to .05 percent of the value of the transaction, and up to one cent for fraud-prevention adjustments. In their complaint, the plaintiffs allege that the Fed acted arbitrarily and capriciously by including in the fees costs that the statute does not allow and in setting an illegal "one-size-fits-all fee" when the statute requires the case-by-case calculation of fees.

This Legal Sidebar outlines the complaint in the case and its background, including how the Fed has interpreted the statute and how the courts have dealt with an earlier case. It concludes with some reflections on possible considerations for Congress.

Background

Prompted by merchant complaints about high debit card fees, Congress in 2010 included the Durbin Amendment (named after the provision's sponsor, Senator Richard J. Durbin) in the Dodd-Frank Act (P.L. 111-203). The Durbin Amendment amended the Electronic Funds Transfer Act (EFTA) to require the Fed to set debit card fees for banks with assets of $10 billion or more. The Durbin Amendment requires that the resulting interchange fees be "reasonable and proportional to the cost incurred by the issuer [cardholder's bank] with respect to the transaction." It delineates the types of costs that the Fed may and

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may not consider in determining the standards. It requires the Fed to "distinguish between (i) the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement [ACS] of a particular electronic debit transaction, which cost shall be considered . . . and (ii) other costs incurred by an issuer which are not specific to a particular electronic debit transaction, which costs shall not be considered." The statute also permits a limited adjustment to the interchange fee for "fraud-prevention costs," and instructs the Fed to consider the similarity between debit cards and payments by check, which banks must clear without deducting a fee.

The Fed determined that the statutory language identifying what costs may and may not be considered is ambiguous and "suggests that Congress left to the [Fed] discretion to consider costs that fall into neither category to the extent necessary and appropriate to fulfill the purposes of the statute." The Fed interpreted this ambiguity to allow the inclusion in the debit card interchange fee of "any cost that is not prohibited." Thus, in calculating the debit card swipe fee cap, the Fed considered costs "that are specific to a particular electronic debit transaction but that are not incremental costs related to the issuer's role in. . . [ACS]." In promulgating Regulation II, therefore, the Fed calculated debit card swipe fee caps based on a variety of costs: "total transactions processing costs (including costs reported as fixed and variable . . . [ACS], network processing fees (*e.g.,* switch fees), and the costs of processing chargebacks and other non-routine transactions), transactions monitoring, and fraud losses."

The Fed also rejected proposals that it tie the cap to the cost of each particular transaction as "virtually impossible to implement" because of the number of possible variables and the inability of the issuer to calculate the cost as the transaction occurs. The potential "reporting burden" was also a reason the Fed cited for choosing a single standard rather than separate standards according to processing network or method of authentication used.

Allegations in the North Dakota Case

To the plaintiffs in *North Dakota Retail Association v. Board of Governors*, the Fed's decision to include the additional category of costs in calculating the debit card interchange fee cap is arbitrary and capricious and should be vacated under the Administrative Procedure Act (APA). The complaint alleges that, in setting the fees, the Fed: (1) considered costs not permitted by the statute; (2) based the fees in part on costs Congress did not permit for interchange fee calculations—e.g., fixed ACS costs, because they are "not 'specific to a particular electronic debit transaction,'" and fraud losses and transaction-monitoring costs, "because Congress required the [Fed] . . . to account for those costs, if at all, through other adjustments . . . ."; and, (3) did not set case-by-case fees "specific to each issuer's specific incremental ACS costs" as the statute allegedly commands. According to the complaint, rather than citing "statutory support," the Fed "justified its approach by pointing to alleged difficulties in discerning each transaction's incremental ACS costs."

One federal appellate court has upheld the Fed's regulation against allegations much like the first two in *North Dakota Retail Association.* The third allegation appears to be novel.

Earlier Litigation

In *NACS v. Board of Governors of the Federal Reserve System* (*NACS*), a group of retail trade associations sued the Fed shortly after it issued Regulation II in final form. They claimed that the final rule, which had almost doubled the 12-cent rate cap the Fed originally proposed, violated the plain meaning of the statute. The U.S. District Court for the District of Columbia (district court) ruled against the Fed, but the U.S. Court of Appeals for the District of Columbia Circuit (D.C. Circuit or court of appeals), generally upheld the regulation in a 2013 decision.

Like the plaintiffs in the current case, the earlier plaintiffs based their allegations on the text of the statute and faulted the Fed for allowing fixed costs and not adhering to the plain statutory language, which

proclaims that costs "not specific to a particular electronic debit transaction . . . shall not be considered." They claimed that, for the 21-cent cap, instead of incremental ACS costs that the statute specified "be considered," the Fed used "'fixed' ACS costs, transactions-monitoring costs, fraud losses, or network processing fees" that the statute does not authorize.

In reaching their decisions, both the D.C. Circuit and district court relied on the framework used by the Supreme Court in *Chevron U.S.A., Inc. v. Natural Resources Defense Council*. The *Chevron* framework requires courts to use a two-step process when they review certain agency rules: (1) if the language of the statute is clear on the particular point, the statutory dictate must be followed; (2) if the statutory language is ambiguous, the courts must defer to a reasonable interpretation of the agency.

The district court stopped at the first step of the *Chevron* analysis, holding that Congress had spoken directly to what costs the Fed may include in capping debit card interchange or swipe fees. The district court determined that the statute does not permit the Fed to include any costs other than "[i]ncremental ACS costs of individual transactions." In contrast, the D.C. Circuit saw itself as confronting a daunting task because of "confusing" statutory language and "convoluted" statutory structure, placing the courts and the Fed in "a bind," "because neither the agencies nor the courts have authority to disregard the demands of even poorly drafted legislation." The court of appeals thus applied *Chevron* step two, scrutinized the Fed's interpretation, and found it reasonable.

The D.C. Circuit looked at the logic, grammar, and purposes of the statute to conclude that there were multiple possible interpretations of "incremental cost." According to the D.C. Circuit, the statute establishes only a floor, not the outer limit, of what costs may be considered in setting the swipe fee cap. It held the Fed's interpretation to be reasonable and ruled that "incremental costs" not associated with ACS may be included in the fee cap calculation, provided such costs are "specific to a particular transaction."

The D.C. Circuit also held the inclusion of other costs to be reasonable, namely: "fixed" ACS costs incurred as part of a transaction; network processing fees paid per transaction; fraud losses from particular transactions; and, transaction-monitoring costs that aid the issuer in deciding whether to authorize a transaction.

The court of appeals remanded the case without vacating the rule and required the Fed to "articulate a reasonable justification for determining that transactions-monitoring costs properly fall outside the fraud-prevention adjustment." In response, the Fed published clarification explaining that the fraud prevention adjustment, which the Fed had amended in 2012, covers "programmatic" fraud prevention measures that are not tied to particular transactions, e.g., researching and developing new technology, rather than the transaction monitoring that is integral to an issuer's decision to authorize a particular transaction. The Fed did not, however, amend the regulation further in response to the remand order. The D.C. Circuit's decision became final on January 20, 2015, when the U.S. Supreme Court declined to hear the plaintiffs' appeal on the rate cap issue.

The Novel Issue in the North Dakota Case

In their complaint, the plaintiffs in *North Dakota Retail Association* raise an issue that did not appear in the earlier litigation. They allege that the statute requires the Fed to set case-by-case fees. They base this assertion on statute's use of the definite article "the" three times when mandating that fees be "reasonable and proportional to *the* cost incurred by *the* issuer with respect to *the* transaction" [emphasis added]. The complaint offers no elaboration on how such a rule could set a workable formula that incorporates costs of specific transactions. A rule based on each transaction, according to the Fed, "would result in an exceedingly complex matrix of interchange fees. . . .[and] introduce tremendous complexity and administrative costs for issuers, networks, acquirers, and merchants, as well as difficulty in monitoring and enforcing compliance."

Statute of Limitations Issue

The plaintiffs in the North Dakota suit also face the possibility that their suit may be outside the six-year statute of limitations applicable to claims under the APA because it is challenging a rule the Fed promulgated in 2011. To overcome that potential hurdle, the complaint characterizes the Fed's "clarification" published in the *Federal Register* on August 14, 2015 in response to the D.C. Circuit's remand order in *NACS* as "the Updated Rule," although the Fed made no changes in the rule. On remand, the Fed elaborated on its rationale for including transaction-monitoring costs in swipe fees rather than in the fraud prevention adjustment, by distinguishing fraud prevention costs that are "integral to authorization" from those that an issuer would not incur for a particular transaction. Although the Fed did not reissue or modify Regulation II, it did offer a way to distinguish the types of costs in each component of the debit interchange standard. Whether that is enough to reset the statute of limitations is unclear. At least one district court has held that a federal agency's reissuing an Environmental Assessment and Finding of No Significant Impact (FONSI) "reinstating its original policy" on remand "renewed the statute of limitation." That decision might be distinguishable, however, because it differs from the North Dakota suit on the issues, the nature of the remand, and the extent of the agency's action on remand.

The North Dakota plaintiffs also claim that their suit is timely under the "associational standing" doctrine established in the Supreme Court's decision in *Lujan v. National Wildlife Federation*. The plaintiffs claim that they are entitled under that doctrine to bring their claim on behalf of certain members of the plaintiffs' associations whose right of action under the APA did not accrue until 2018, when they began accepting debit cards.

Considerations for Congress

The North Dakota suit raises issues regarding the purported ambiguity of the statutory language of the Durbin Amendment and the Fed's interpretation of that language. Congress thus might consider legislation clarifying precisely what costs may and may not be included in the calculation of debit card swipe fee caps. Congress also may examine the practical effects of the caps, possible modifications, or even legislating express caps for credit card interchange fees. North Dakota retailers may be reacting to stress that retailers in other states claim to be experiencing. The Fed has not adjusted the debit card swipe fee cap since establishing them in 2011, although it reports that the average ACS costs to issuers in 2019 was one-half that in 2009.

Congress last dealt with the regulation of debit interchange fees in 2017 when the reported version of H.R. 10, the Financial CHOICE Act of 2017, included a repeal of the Durbin Amendment that was not included in the House-passed version. According to the House Financial Services Committee Report, not only had the debit card swipe cap failed to bring lower prices or enhanced services to consumers, it had meant fewer free checking accounts and debit card rewards programs.

The 117th Congress may see more efforts from trade groups seeking legislation to address dissatisfaction with debit card fee caps. Retail trade associations, such as the National Retail Federation, are claiming that debit card swipe fees hurt consumers and are "a growing windfall" for banks. Another critic of the caps is the Electronics Payments Coalition, which represents some banks, credit unions, and payment card networks. Other retail trade groups, such the National Restaurant Association, may seek legislation to extend the interchange fee cap to credit card transactions. In a recent letter to Ranking Members of congressional banking committees, Americans for Tax Reform argued that the idea would create more price controls and no benefits to consumers.

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