ELECTRONIC PAYMENTS 2011:
THE WINDS OF CHANGE / A CALL TO ACTION

By

W. Stephen Cannon
Richard O. Levine

Constantine Cannon LLP

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ABOUT THE AUTHORS

W. Stephen Cannon is Chairman of Constantine Cannon LLP and the Managing Partner of Constantine Cannon's Washington, DC office. Constantine Cannon is a law firm with extensive experience in electronic payments matters, and served as lead counsel for U.S. merchants in the *Visa Check/MasterMoney* debit card litigation and the resulting settlement. The firm currently serves as counsel to the Merchants Payments Coalition regarding its submission of comments to the Federal Reserve Board in its rulemakings implementing the payment card provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Prior to joining the firm in 2005, Steve served as General Counsel of Circuit City Stores, Inc. for 11 years. Prior to Circuit City, Steve was a partner in a Washington law firm, and previously served as deputy assistant attorney general in the Antitrust Division of the U.S. Department of Justice, and Chief Antitrust Counsel to the U.S. Senate Judiciary Committee. He has testified before the Senate and House Judiciary Committees regarding payment card interchange fees on behalf of the Merchants Payments Coalition. Steve can be reached at 202-204-3502, scannon@constantinecannon.com.

Richard O. Levine is of counsel to Constantine Cannon LLP. A former Director of the Office of Policy Planning of the U.S. Department of Justice’s Antitrust Division, Richard’s practice focuses on the intersection of competition law, government economic regulation, and technological change. He has been active in payment card issues since joining the firm in 2005. Richard can be reached at 202-204-3511, rlevine@constantinecannon.com.

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I. SCOPE AND SUMMARY

Policymakers increasingly are focusing on the contentious relationships between the major payment card networks and the merchants who accept payment cards. In a paper submitted for last year's conference,[1] we noted that the major card networks—Visa and MasterCard—had continued to make payment card acceptance an increasingly expensive and burdensome proposition: first through increased fees—particularly interchange fees—imposed on payment card acceptance; and second through card networks' use of merchants' agreements with their acquiring banks to ensure that merchants were placed at the bottom of a "liability cascade" in cases of claimed card data breaches. We also noted that the card networks' operating rules restricted merchants' ability to provide discounts based on their customers' choice of payment method.

During the past year, both Congress and the Justice Department's Antitrust Division addressed these issues, with Congress—and at its direction—the Federal Reserve Board ("Board"), becoming a major catalyst for change. These changes have the potential to reduce significantly the burdens placed on hospitality industry participants from their acceptance of debit cards.

On July 21, 2010, President Obama signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). The Act included the "Durbin Amendment," sponsored by Sen. Richard Durbin (D.-Ill.), which authorizes the Board to conduct a series of rulemakings regarding the fees and rules that govern merchant acceptance of debit cards.[2] In addition, the Durbin Amendment expressly gives merchants the right to use discounts or other incentives to steer customers toward the payment types of their choice; however, this right does not extend to differing payment networks or issuers of a particular type of card.

The Board issued its proposed regulations implementing the Durbin Amendment on December 16, 2010. Comments are due on these proposals by February 22, 2011. While not perfect from the merchants' perspective, the proposals represent a solid and thoughtful attempt to implement the Durbin Amendment's policy mandates. It remains to be seen however, whether the Board's final rules will confirm the Durbin Amendment's merchant protections.

On October 4, 2010, the Justice Department's Antitrust Division filed a Sherman Act complaint against Visa, MasterCard and American Express concerning their anti-steering rules, and simultaneously filed a proposed settlement with Visa and MasterCard eliminating some of the card networks' restrictions on merchants' ability to provide

[1] W. Stephen Cannon, Constantine Cannon LLP and Michael McCormack, Palma Advisors, LLC, *The U.S. Payment Card Industry: Select Challenges and Issues from a Hospitality Industry Perspective* (2010 Hospitality Law Conference).
[2] The Amendment is section 1075 of the Dodd-Frank Act, Public Law 111-203, and enacts a new section 920 of the Electronic Fund Transfer Act, 15 U.S.C. § 1693o-2.

discounts and other customer incentives regarding payment choices. This settlement likely will be entered after a court hearing this spring. (American Express chose to litigate the Justice lawsuit.)

These developments promise significant benefits for members of the hospitality industry—and require the active involvement of industry counsel in ensuring that their clients take advantage of opportunities as they arise. Most importantly:

- The average 44 cents-per-transaction interchange fee for each debit card use could decline significantly, potentially to seven to 12 cents under initial Board proposals, and even less if the merchant community's proposals are adopted;

- Merchants should gain greater control over which network processes a debit card transaction, particularly if the Board requires each debit card that can use the "signature" method of authorization (i.e., using the facilities of a credit card network) to be connected to at least two such networks;

- Payment card networks should have an increased incentive to negotiate with merchants to become preferred payment card providers in return for priority in debit routing and favorable treatment under the rights provided by the Durbin Amendment and the Justice Department consent decree to "steer" customers to a merchant's preferred form of payment; and

- Incentives may be created for migration of today's card authentication process to more secure methods, a step being taken in almost all countries outside the United States.

However, the outcome of the rulemaking process is by no means certain, and merchants' potential gains may be reduced.

Section II of this paper summarizes the hospitality industry's stake in the payment card debate and the problems that gave rise to these initiatives, noting recent state statutes affecting merchants' card data breach liability. Section III details the new rights given to merchants under the Durbin amendment and details the range of options being considered by the Board to implement those aspects of the Durbin Amendment requiring regulatory elaboration. Section IV then analyzes the Department of Justice's pending settlement with Visa and MasterCard.

Finally, Section V highlights the need for the hospitality industry to remain alert to efforts by card networks and their card-issuing members to undercut the benefits to merchants from Durbin Amendment reforms. It also encourages hospitality industry counsel to ensure that their clients take advantage of the opportunities growing out of the legal and regulatory changes affecting the relationship between merchants and payment card networks as the nature of those changes becomes more clear.

II. BACKGROUND

A. The Hospitality Industry's Stake in the Payment Card Debate

Payment cards are the predominant customer payment mechanism for hospitality merchants, comprising over 80 percent of sales at lodging establishments, and 70 percent at higher-priced table service restaurants.[3] Debit cards have become increasingly important to mid-price and quick service restaurants, largely due to the declining use of cash. At mid-price restaurants, debit card usage has increased to 29 percent in 2008 from seven percent in 1999; at quick-service restaurants, the increase was to 33 percent in 2008 from less than two percent in 1999 (2008 credit card usage was 39 percent and 15 percent, respectively).[4]

Merchant payment card acceptance has become increasingly complicated due to an evolving labyrinth of fees, escalating fee levels and types, grossly one-sided acceptance agreements, and restrictive acceptance rules. Further, over the prior decade, merchants have found themselves subject to an amorphous data security regime, designed to shift liability to merchants, in some cases regardless of whether the merchant complied with the data security rules.

Members of the hospitality industry usually work with multiple entities in order to accept payment cards. At the center of the process, merchants enter into a merchant card processing agreement with a bank (called the "acquiring" bank). This agreement generally requires that merchants comply with the rules established by the payment card networks. The acquirer's general responsibility is to accept payment card transactions from the merchant, process them with the payment card networks, and settle funds with the merchant.

Aside from bank acquirers, there are also significant non-bank acquirers such as First Data and Heartland Payment Systems who sell merchant services, contract with merchants and manage merchant's processing. Nonetheless, the non-banks are required by the card networks to affiliate with a bank to sign merchant agreements and operate their card acceptance services.

Apart from the banks and their third party agents, hospitality merchants contract with third parties for property management and point-of-sale systems installation and maintenance. Hospitality merchants may also contract with entities known as payment gateways which provide transaction routing, reporting, and transaction management functions.

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[3] Visa Payment Systems Panel Study, *Visa 2006 Payment Trends Summary*, at 15, www.bos.frb.org/economic/eprc/conferences/payments2006/papers/hampton.pdf.
[4] Federal Reserve Bank of Philadelphia Payment Cards Center, *Trends and Preferences in Consumer Payments: Lessons from the Visa Payments Panel Study*, at 8 (May 2010), http://www.philadelphiafed.org/payment-cards-center/publications/discussion-papers/2010/D-2010-Visa-Payment-Panel-Study.pdf.

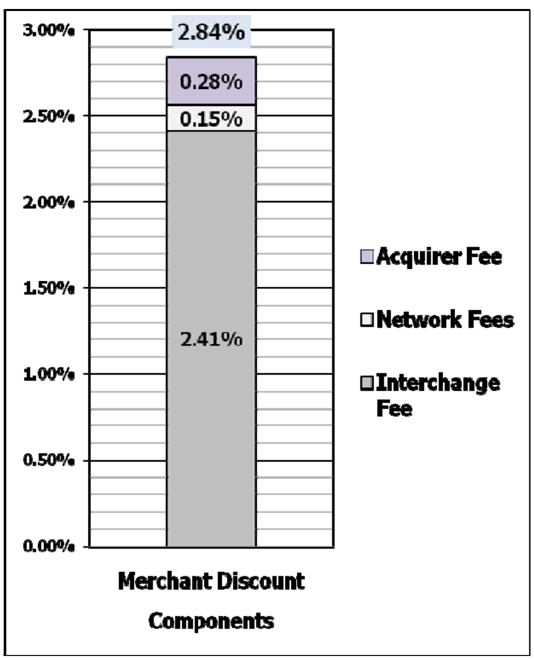
B. Payment Card Acceptance Fees

U.S. merchants' general purpose payment card processing expenses have risen dramatically since the early 1990s. While some of the increased expense is attributable to higher levels of consumer use of payment cards, much of the increased expenses are due to interchange fee levels which have markedly increased.

The majority of payment card expenses are the combined fees paid by merchants to the card issuers, acquirers, and payment card networks. Hospitality merchants' credit card acceptance fees in the United States are usually in excess of two percent of the transaction sale amount and depend on multiple factors; and debit card payments may average over one percent. While most of the fee is charged by the issuer as "interchange," other components are charged by the payment networks, and the acquiring bank.

Merchants also usually bear third party systems and technology expenses associated with card acceptance, amounts that are usually significantly less than the interchange fees paid to card-issuing banks. For illustration, Figure 1 is the combined average direct acceptance cost of Visa or MasterCard U.S.-issued premium or corporate credit card sales at a U.S. hotelier in 2009.

<u>Figure 1 – Average Visa and MasterCard Credit Card Acceptance Cost: Premium or Corporate Card at U.S. Hotels</u>



<u>Sources</u>: Palma Advisors, LLC calculations derived from: *The Rising Interchange Tab*, Digital Transactions Magazine, at 8 (Feb. 2008); *Those Other Merchant Fees*, Digital Transactions Magazine, at 22 (Dec. 2009); Visa's U.S. interchange fee schedule at usa.visa.com/merchants/operations/interchange_rates.html; MasterCard U.S. interchange rates at www.mastercard.com/us/merchant/acceptance/interchange_rates.html.

Debit card interchange fees historically have varied by authentication method. "Signature debit" is authorized over the same payment networks used by Visa and MasterCard to process credit card transactions—and signature debit fee levels and categories have tended to follow credit card rate levels and categories.[5] PIN (Personal Identification Number) debit requires entry of such numbers using PIN pads at merchant sales terminals and authorization is over regional and national networks used for ATM transactions, including Visa's Interlink and MasterCard's Maestro networks. Interchange fees for PIN debit historically have been lower than for signature debit—initially some PIN networks *paid* merchants for PIN transactions to help compensate for the costs of PIN pads—but have tended to converge with signature fees in recent years—undoubtedly following the pricing umbrella provided by Visa and MasterCard signature rates.[6]

According to the Board, debit and prepaid card interchange fees paid to issuers by merchants and their acquirers amounted to $16.2 billion in 2009.[7] Average transaction fee levels were:

- All debit authentication methods- 44 cents or 1.14 percent
- Signature debit- 56 cents or 1.53 percent
- PIN debit- 23 cents or 0.56 percent

By contrast, in the late 1990s, PIN debit fees were about seven cents per transaction.[8] The Durbin Amendment was, in large part, intended to address the current high level of debit interchange fees, which as Sen. Durbin explained to his Senate colleagues, reflected the card networks' market power over merchants, in contrast to the at-par (face value) clearance of the checks that debit cards have increasingly replaced:

> Right now in the United States, there are zero transaction fees deducted when you use a check. The Federal Reserve does not allow transaction fees to be charged for checks. But when it comes to debit cards, Visa and MasterCard charge high

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[5] *See* Board of Governors of the Federal Reserve System, Debit Card Interchange Fees and Routing- Notice of Proposed Rulemaking, 75 *Fed. Reg.* 81722, 81724 (Dec. 28, 2010). Prior to the 2003 *Visa Check/MasterMoney* settlement, merchants who accepted Visa and MasterCard credit cards were compelled also to accept the networks' signature debit cards, so there was no incentive for the networks to charge lower interchange fees for debit cards compared to credit cards. Under the settlement, merchants were given the right to make independent acceptance choice regarding credit and debit cards, and signature debit fees fell somewhat.

[6] *Id.* at 81724; *see* Submission of the Merchants Payments Coalition to the Board of Governors of the Federal Reserve System Regarding Section 920 of the Electronic Fund Transfer Act, at 4 (Oct. 27, 2010) ("Merchants Payments Coalition Oct. 27, 2010 Submission"), http://www.federalreserve.gov/newsevents/files/merchants_payment_coalition_meeting_20101102.pdf (beginning at PDF page 234).

[7] 75 *Fed. Reg.* at 81725.

[8] *Id.* at 81725 n. 23.

> interchange fees just as they do for credit. Why? Because they can get away with it. There is no regulation, there is no law, there is no one holding them accountable.[9]

C. The Card Networks' Control Over Point-of-Sale Payment Type Discounts and Customer "Steering"

Under the card networks' Operating Rules—with which merchants must comply pursuant to their "acceptance" agreements with their acquirers—merchants historically have had little freedom in dealing with customers who offer cards as a form of payment: merchants must honor all credit or debit cards issued by the card system's members, even if they are "premium rewards" cards carrying higher interchange fees. Thus, MasterCard prohibits a merchant from providing *any* payment discount other than for cash, and also expressly prohibits merchants from charging customers for any fees they must pay to MasterCard or its members.[10] Visa superficially has been a little more "flexible," permitting discounts so long as they do not provide an advantage to a direct Visa competitor:

> A Merchant may offer a discount as an inducement for a Cardholder to use a means of payment that the Merchant prefers, provided that the discount is:
>
> - Clearly disclosed as a discount from the standard price and
> - Non-discriminatory as between a Cardholder who pays with a Visa Card and a cardholder who pays with a "comparable card."
>
> A "comparable card" for purposes of this rule is any other branded, general purpose payment card that uses the cardholder's signature as the primary means of cardholder authorization (e.g., MasterCard, Discover, American Express). Thus, any discount made available to cardholders who pay with "comparable cards" must also be made available to Cardholders who wish to pay with Visa Cards.[11]

However, Visa contradicted the supposed flexibility of its allowable card discount with an "advertised price" rule which prohibits promoting at the point-of-sale any discounts using the merchant's co-branded cards and which requires that:

> Any purchase price advertised or otherwise disclosed by the Merchant must be the price associated with the use of a Visa Card….[12]

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[9] 156 *Cong. Rec*. S3696 (May 13, 2010).
[10] MasterCard, *MasterCard Rules* § 5.9.2 (Nov. 6, 2009), http://www.mastercard.com/us/merchant/pdf/BM-Entire_Manual_public.pdf.
[11] Visa U.S.A. Inc., *Operating Regulations- Volume I, General Rules* (Public Ed., Nov. 15, 2008), at § 5.2.D.2.b http://usa.visa.com/download/merchants/visa-usa-operating-regulations.pdf.
[12] *Id.* at §§ 5.2.D.1, 5.2.D.3.

Of course, an agreement imposed by dominant firms as to the price at which you can sell a competitor's product would appear to be an "agreement in restraint of trade." The Justice Department recognized this fact and its October 2010 proposed settlement with Visa and MasterCard, discussed in Section IV, provides potential relief regarding permitted merchant incentives regarding customers' payment card choices, in addition to those established by the Durbin Amendment.

D. The Payment Networks Compel Merchants to Bear a Major Portion of the Risk Imposed by Their Authorization Mechanisms

The authentication systems used by Visa and MasterCard for credit and debit card transactions place merchants in significant financial jeopardy from two key sources:

a. **Charge-backs** through which merchants may have to accept a loss associated with a claimed fraudulent transaction involving goods or services purchased from the merchant or using a card that the network claims was counterfeited as a result of a alleged "data compromise" for which the network has found the merchant liable; and

b. The imposition of **penalties and liabilities** administered by Visa and MasterCard for alleged violations of payment card industry data security standards ("PCI-DSS"). Indeed, the card systems have set themselves up as prosecutor, judge, and jury to penalize merchants and others with expressly denominated "fines," potentially amounting to hundreds of thousands of dollars, for claimed data security violations.[13] These penalties automatically can be deducted from merchants' card acceptance cash flows pursuant to provisions in many merchant acceptance agreements.

In assessing penalties and liabilities, the card systems have simply presumed themselves to have governmental powers of punishment through mandated compliance with card system operating rules that no merchant ever signs directly. Liability may be found through, e.g., Visa's "Account Data Compromise Recovery" program on the basis of "common point of purchase" investigations (i.e., the most "common" merchant with claimed fraudulent transactions among a group of cards with reported fraud) and use of algorithms comparing "actual" versus "expected" fraud associated with cards used at a merchant so identified.[14] And a merchant's ability to contest a network's decision may

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[13] For a discussion of the PCI security costs imposed on merchants by the major card networks, *see* W. Stephen Cannon and Michael McCormack, *"The Currency of Progress?" Visa and MasterCard Arrogate Governmental Powers In the Name of Card System Security*, PCI Compliance Newsletter for Hotels & Restaurants (Dec. 2009), http://www.hospitalitylawyer.com/Newsletters/PaymentSecurity_Nov09.pdf.

[14] *See, e.g.*, Visa, Inc., *What Every Merchant Should Know About the New Account Data Compromise Process* (2006); http://usa.visa.com/merchants/operations/adcr.html#anchor_5; MasterCard, *Security*

be dependent on the actions of its acquirer.[15] This situation is particularly troubling, given Visa and MasterCard's market power—there is no practical alternative to acceptance of those systems' cards. Additionally, some states permit card issuers to seek direct reimbursement from merchants for claimed damages arising from claimed data breaches.[16]

Indeed, the most recent state law on this subject, adopted in 2010 by Washington State, provides more due process protections to merchants than provided by the card associations' unilateral procedures. Under Chapter 151, Laws of 2010,[17] a merchant processing more than six million credit and debit card transactions annually may be liable to an issuer for the costs of reissuance of credit and debit cards, but only if it proves: (a) the business failed "to take reasonable care" of card account information in its possession or control; (b) "the failure is found to be the proximate cause of a breach;"[18] and (c) the claimed reissuance costs are reasonable. Further, the liability is to be allocated among "every entity that was the proximate cause" of the claimant's damages. Defenses are: (a) that the data was encrypted, and (b) that the merchant was certified as PCI compliant.

The Durbin Amendment required the Board to collect information regarding the incidence of debit card fraud as part of its "fraud prevention adjustment" rulemaking. Based on collected data, the Board confirmed that the type of authentication method used greatly affects the level of debit card fraud, with reported per-dollar signature debit levels of fraud 3.75 times greater than PIN debit losses overall (13.1 basis points v. 3.5 basis points), and four times the level for card-present transactions.[19] The Board explained why:

> These different fraud rates reflect, in part, differences in the ease of fraud associated with the two authorization methods. A signature debit card transaction requires information that is typically contained on the card itself in order for card and cardholder authentication to take place. Therefore, a thief only needs to steal

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Rules and Procedures- Merchant Edition § 10.2.4.3, ADC Operational Reimbursement and ADC Fraud Recovery (Jan. 29, 2010).

[15] *See* Visa, *Visa International Operating Regulations*, at 752 (Public Ed., Apr. 1, 2010).

[16] In 2007, Minnesota adopted a statute expressly giving financial institutions the right to seek reimbursement from merchants in that state for expenses arising from Minnesota merchants' data breaches and otherwise unreimbursed through card network procedures. Specified damages include card reissuance costs and cardholder notification and fraudulent charge reimbursement. Breached data must involve account security codes or PINs that were stored after authorization. Minnesota Statutes, section 325E64. *See also* Nev. Rev. State 603A.215, § 1(3), effective Jan.1, 2010, establishing the responsibility of a business that accepts payment cards for compliance with PCI data standards and making compliance with such standards a defense to liability "for damages for a breach of the security" of its system.

[17] Codified at section 19.255.020, Revised Code of Washington.

[18] Defined to be an "unauthorized acquisition of data," RCW § 19.255.010(4).

[19] 75 *Fed. Reg.* at 81741.

> information on the card in order to commit fraud. In contrast, a PIN debit card transaction requires not only information contained on the card itself, but also something only the cardholder should know, namely the PIN. In this case, a thief needs both the information on the card and the cardholder's PIN to commit fraud.[20]

Further, the Board found that merchants bore little of the cost of fraud losses arising from PIN debit transactions, but a significant share of signature debit fraud: 96 percent of losses resulting from PIN debit transactions were borne by issuers, while signature debit fraud losses were reported to be more evenly split, with 55 percent of losses borne by issuers and 45 percent by merchants. However, merchants bore about 76 percent of losses in card-not-present transactions.[21]

Given that merchants shoulder much of the burden of signature debit fraud losses (in addition to higher signature debit interchange fees), it is not surprising that card issuers continue to promote signature debit over PIN debit. In some cases, issuers grant rewards only in the case of signature transactions or impose per-use charges when card holders choose to process a debit transaction by entering a PIN. Moreover, both signature and PIN utilize the same fundamental authentication function that creates risks—network communication of verification data contained on the card to a central authorization database.

There are other, more secure, authentication technologies. For example, the United States appears to be the only major developed country that is not transitioning to use of "chip and PIN" technology in which a customer-entered PIN is compared with data contained in a computer chip embedded in the card, eliminating the need to transmit verification information.[22] While a migration to chip and PIN involves implementation costs, lack of chip and PIN cards and terminals may lead to increasing difficulties for U.S. card holders going abroad (where merchants may no longer have the ability to authenticate magnetic stripe cards), and for domestic hospitality industry locations catering to foreign customers whose cards eventually may be without a means of magnetic stripe verification.[23]

III. The Federal Reserve Board's Durbin Act Rulemakings Have the Potential to Provide Significant Benefits to the Hospitality Industry

Following the Dodd-Frank Act's enactment, the Board undertook a program of "transparent" outreach to stakeholders regarding required Durbin Amendment rulemakings. As part of this effort, the Merchants Payments Coalition ("MPC")—representing a broad spectrum of merchants, including the National Restaurant

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[20] *Id.* (footnotes omitted).
[21] *Id.*
[22] *See* Merchants Payments Coalition Oct. 27, 2010 Submission, at 11.
[23] *See The end for the magnetic stripe on payment cards?* http://www.finextra.com/community/fullblog.aspx?id=4621 (Oct. 27, 2010).

Association and the National Council of Chain Restaurants—filed issue papers and expert reports,[24] as well as participated in meetings with the Board staff members. This section first sets out an overview of Durbin Amendment provisions, and then analyzes each of the rulemakings, first setting out the merchants' recommendation, followed by a discussion of the Board's draft rules.

A. The Durbin Amendment's Mandates

Overview. The Dodd-Frank Act broadly expands federal regulatory oversight of the financial services sector of the economy. Section 1075 of the Dodd-Frank Act, introduced as an amendment sponsored by Sen. Richard Durbin (D.-Ill.), created a new section 920 of the Electronic Fund Transfer Act ("EFTA"), which generally governs consumers' rights regarding debit cards, ATMs, and other non-credit electronic transactions. Unlike other sections of the EFTA, which are being transferred to the jurisdiction of a newly created and independent Bureau of Consumer Financial Protection within the Federal Reserve, section 920 will remain under the authority of the Federal Reserve Board, itself.

In turn, the Board is to conduct a series of rulemakings to be completed by April 21, 2011 to implement section 920's mandates. The Board issued its proposed rules on December 16, 2010, and comments are due by February 22, 2011. The major components of section 920 and their related Board rulemakings are discussed below, highlighting the positions taken by the MPC and the Board's December 16 proposals on which it has sought comment.

Interchange Fees. Under subsection 920(a), by mid-April 2011, the Board is to promulgate rules to ensure that "interchange fees" collected by a payment network's card issuers for debit card[25] transactions are "reasonable and proportional" to card issuers' incremental costs for processing debit card transactions. These rules are to take effect in July 2011. In implementing the "reasonable and proportional" interchange fee standard, the Board is to consider both: (1) the functional similarity between electronic debit transactions and checking transactions that are required within the Federal Reserve System to clear at par; and (2) "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." However, debit card issuers with less than $10 billion in assets (including affiliates' assets) are excluded from interchange fee controls, so the aggregate impact on

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[24] Merchants Payments Coalition Oct. 27, 2010 Submission, http://www.federalreserve.gov/newsevents/files/merchants_payment_coalition_meeting_20101102.pdf. The MPC proposals were supported by the expert reports of Prof. Steven C. Salop of the Georgetown University Law Center and industry experts Steven C. Mott and Kenneth J. Morrison.

[25] "Debit card" is defined to include general purpose gift or prepaid cards where the cardholder can use the card at multiple merchants, but excludes benefit cards and prepaid cards of a type used by individuals without checking accounts. Paragraphs 920(a)(7), (c)(2).

merchants' fees may depend on the mix of small and large card-issuers' cards used by the merchants' customers.

The "Fraud Prevention Adjustment" Rulemaking. By mid-April 2011, the Board also must complete a rulemaking establishing standards by which card issuers may seek to adjust their allowed interchange fees to take into consideration their "fraud prevention" costs. EFTA subsection 920(a)(5) authorizes the Board to make "adjustments" to interchange fee amounts received by an issuer if "such adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to" debit card transactions involving the issuer. However, such adjustments are allowed only if the issuer (not the network) complies with Board-developed fraud adjustment standards.

Significantly, in developing these standards, the Board is to take into consideration the effect of authorization type (e.g., PIN vs. signature) on fraud levels and to require issuers to "take effective steps" to reduce fraud "including through development and implementation of cost-effective fraud prevention technology." Further, in developing the standards, the Board is to consider: (1) the nature and type of fraud in electronic debit transactions; (2) the extent to which fraud depends on the form of authorization, including PIN, signature, or other means; (3) "the available and economical means" by which fraud on electronic debit transactions may be reduced; (4) the fraud prevention and data security costs expended by each party to an electronic debit transaction, including by consumers and merchants; (5) the cost of fraud absorbed by each party to a transaction, including by consumers and merchants; (6) the extent to which interchange fees have reduced or increased incentives for parties in electronic debit transactions to reduce fraud; and (7) such other factors as the Board considers appropriate. Further, any adjustment allowed must take into account any fraud-related reimbursement received by issuers, such as charge-backs.

Network Fees. Section 920(a)(8) gives the Board jurisdiction over "network fees," fees established by networks with respect to debit card transactions that are not "interchange fees," but only for two narrow purposes. The first is to ensure that these fees do not directly compensate issuers for their role in handling debit card transactions. The second is to ensure that network fees are not otherwise used "to circumvent or evade" the interchange fee restrictions. This provision reflects a Conference Committee compromise: as passed by the Senate, section 920(a) gave the Board the power directly to limit the fees charged by card networks with respect to debit transactions, but the conference negotiators concluded that the Board's powers should be limited to preventing networks from using their fees to flout the debit card interchange fee rules.

Prohibition on Limiting Debit Card Transactions to One Network. Subsection 920(b)(1) is intended to inject competition among debit card networks for debit card processing. The Board is to issue regulations prohibiting payment card networks or issuers, as well as their processors and agents, from restricting to only one (or to only one affiliated group) the number of networks on which an electronic debit transaction may be processed. Similarly, networks and issuers may not inhibit merchants' ability to direct the routing of debit transactions "over any payment network that may process such transactions."

In his Senate floor comments prior to final passage of the Dodd-Frank Act, Sen. Durbin stated that the routing provision is to be interpreted broadly by the Board in drafting the implementing regulations:

> This paragraph 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, and the Board's regulations should ensure that networks or issuers do not try to evade the intent of this amendment by having cards that may run on only two unaffiliated networks where one of those networks is limited and cannot be used for many types of transactions.[26]

If issued in this manner, the Board's regulations may bring about a significant change in the dynamics of competition among payment card networks. Assuming the Board requires card issuers affirmatively to seek interconnection with multiple payment networks for each debit card authentication method, debit cards should be "bugged" with multiple network logos for both PIN and signature authorization. In turn, merchants should have the discretion to choose whether to route a transaction over the Visa or the MasterCard network, if those are among the multiple networks chosen by the card issuer.

Merchants' Discounting Rights and Minimum Transaction Size Limits. Finally, new EFTA subsection 920(b)(2) prevents payment networks or card issuers from restricting merchants' ability "to provide a discount or in-kind incentive for payment by the use of cash, checks, debit cards, or credit cards." However, the provision does not require that card networks allow merchants to differentiate in their discounts or incentives on the basis of credit or debit card issuers or networks. And section 920(c)(4) defines "discount" to be a reduction from "the price that customers are informed is the regular price," and does not include a means of increasing the price above the regular price (e.g., a surcharge). Also, the subsection allows merchants to set a $10 minimum for credit card (not debit card) transactions. Unlike other key provisions of the Durbin Amendment, section 920(b)(2) is self-enforcing and does not require the Board to issue implementing regulations. (The Board may, however, increase the allowed $10 credit card acceptance floor by means of a rulemaking proceeding.)

Section 920(b)(2) thus provides merchants with a limited set of rights—in effect today—that increase merchants' flexibility in accepting cards as a means of payment. The pending settlement between the Justice Department and Visa and MasterCard, if entered, discussed in Section IV, may, however, have significantly more impact, since it prevents those card networks' rules from restricting merchants from providing differing incentives by network and by types of credit or debit cards that have different levels of interchange fees.

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[26] 156 *Cong. Rec*. S5926 (July 15, 2010).

The small issuer exemption. In a concession to credit unions and "community" banks, pursuant to section 920(a)(6) debit card issuers with less than $10 billion in assets are exempt from the Durbin Amendment's interchange fee restrictions (but remain subject to limitations on card routing exclusivity). As a result, these restrictions apply to only approximately 85 large issuers, which, however, are responsible for an estimated 65 percent of debit card volume.[27]

Reportedly, Visa will implement a "two-tier" fee system that will charge merchants different interchange fees based on whether a customer uses a debit card issued by an exempt or non-exempt financial institution.[28] Thus, the relative savings from reductions in larger banks debit interchange fees may depend on merchants' customers' mix of cards from large and small banks.

B. Merchant Rulemaking Proposals and the Board's Draft Regulations for Comment

On December 16, the Board adopted a Notice of Proposed Rulemaking addressing all four of the Durbin Amendment's required rulemakings. Each of the following sections begins with the MPC's proposal, and then a description of the rules the Board issued for comment.

1. Debit Card Interchange Fees

a. What merchants suggested

In its pre-rulemaking comments to the Board, the MPC proposed that the Board's interchange fee standard be based on a presumption that debit card interchange be at par (i.e. no payments to issuers from acquirers and their merchant customers). This was so for six reasons:

1. At-par interchange would increase consumer welfare compared to positive interchange fees, which increase retail prices for all of a merchant's customers, but are not fully reflected in card issuers' benefits to cardholders;

2. Incentives for issuers to reduce their operational costs would be increased if they had to bear all their debit card transactional costs, rather than having them subsidized by payments from merchants;

3. Consumer equity would be increased, since increased merchant costs from positive interchange are borne by all consumers, including cash customers,

[27] *See* 156 *Cong. Rec*. S3704 (May 13, 2010) (Remarks of Sen. Durbin).
[28] PaymentSource, *Visa Plans Two-Tiered Interchange Rates Following Fed Rules* (Jan. 7, 2011).

who tend to have less income (i.e., interchange fees operate as a regressive tax on customers);

4. Experience in other countries has demonstrated that interchange fees are not necessary to the growth of viable debit card payment systems;

5. An at-par system would prevent the networks from using their market power to bid up interchange fees above competitive levels, an outcome recognized by Federal Reserve economists; and

6. An at-par system would be the easiest to administer, since there would be no need to define and audit issuer cost justifications for particular fee levels.

The MPC suggested that an acceptable approach would be to permit individual issuers to rebut the at-par presumption, but only to the extent that they could show that their receipt of positive interchange payments would advance consumer welfare. Further, any such costs should be limited to an issuer's narrowly-defined incremental costs of authorization, clearance, and settlement ("ACS") of debit transactions and be subject to a cap. This cap initially would be set at the cost of signature debit ACS, calculated by the MPC's industry expert to be 1.36 cents per transaction, declining over three years to the ACS cost of PIN debit, or 0.33 cents per transaction, so as to encourage migration to more secure and efficient authorization mechanisms.

b. What the Board proposed

While the Board's proposal did not adopt at-par interchange as the default standard, it did adopt the concept of capped fees—but at levels above those that MPC had proposed. In so doing, the Board solicited comments on two approaches whose quantitative levels were determined using the results of cost surveys sent to issuers. Under its first alternative, each issuer would calculate its level of allowable ACS "average variable" costs (total variable ACS costs divided by the number of transactions), which apparently could include outsourced ACS activities at whatever level the outsourcing contractor billed, up to a cap of 12 cents per transaction. These allowable costs exclude cardholder rewards, fees paid to card networks, or inquiries about specific transactions. According to the Board, this level represented recovery at the 80th percentile of issuers, and would encourage issuers with higher costs to reduce their costs.[29] The Board stated that this amount was a significant reduction from the estimated 44 cents-per-transaction interchange fee in effect today. In addition, issuers could avoid the need to undertake a cost study if they complied with a "safe harbor" cap of seven cents per transaction, an amount set at the 50th percentile issuer cost level, with issuers with lower costs retaining the benefit of their relatively more efficient operations.[30]

[29] 75 *Fed. Reg.* at 81737.
[30] *Id.*

Under the second alternative, issuers could charge up to the 12 cents-per-transaction cap without the need for individual cost justification. According to the Board, this approach would create incentives for issuers to reduce their transaction processing costs to levels below the cap, while eliminating the potential incentive under the first alternative for those with below-cap costs to increase those costs to justify higher fees. Finally, issuers' administrative costs would be lower.[31]

Under either alternative, card networks could structure their debit interchange fees as they wished, so long as the average interchange fees remained in accordance with their issuers' allowable fee levels, although the networks remain free to set lower average levels. Variations could include differences between PIN and signature authorizations, card-present and card-not-present transactions, and different rates for different merchant categories, and the Board sought comment on this approach. In addition, fees could be set on a per-transaction and/or *ad valorem* basis, again, so long as the per-transaction issuer average was maintained.[32] The Board also sought comment on giving networks greater flexibility by permitting the cap to apply at the network level, rather than issuer-by-issuer.[33]

2. The Fraud-Prevention Adjustment to Interchange Fees

a. What merchants suggested

The MPC comments argued that any fraud adjustment provision must reflect the fact that the current interchange fee system incentivizes issuers to promote cardholder use of the highest-fraud authentication method—signature debit—and shifts a significant share of signature debit fraud losses to merchants. Further, merchants are forced to bear the high costs associated with compliance with network-imposed PCI security standards. Indeed, the MPC noted that the then-Chairman of the House Homeland Security Committee expressed concern that the "payment card industry's effort to shift risk appears to have contributed to our current state of insecurity" and that the networks appear to be "less interested in substantially improving their product and procedures than they are with reallocating their fraud costs."[34]

Low-fraud technology exists, such as the chip-and-PIN approach being implemented in almost all other developed countries, and other approaches may be possible. While not endorsing any new authentication method, the MPC argued that the Board has an opportunity to create incentives for a "paradigm shift" in fraud-reducing technology for payment card authentication that could reduce fraud to levels below that for PIN debit. Consequently, the Board should withhold implementing an interchange

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[31] *Id.* at 81738.
[32] *Id.* at 81736, 38.
[33] *Id.* at 81738-39.
[34] Statement of Committee Chairman Bennie G. Thompson, *Do the Payment Card Industry Data Standards Reduce Cybercrime?* (Mar. 31, 2009), *quoted in* Merchants Payments Coalition Oct. 27 Submission, at 12.

fee fraud adjustment until an appropriate technology is adopted in the United States and used for an appreciable volume of debit transactions.

The MPC suggested that, once the transition had begun, the Board could adopt a fraud-prevention adjustment that could be capped and based upon the relative costs incurred by issuers and by merchants/consumers related to that low fraud technology. The fraud adjustment fee would be positive (i.e., it would increase the debit interchange fee) if the issuer's costs exceed the collective costs of merchants and consumers, and the fraud adjustment fee would be negative (i.e., it would decrease the debit interchange fee) if the merchants' and consumers' collective costs exceed those of the issuer.

b. What the Board proposed

The Board's rulemaking notice concluded that the fraud-prevention fee adjustment was sufficiently complex and fact-specific that it could not yet propose a specific rule. Nevertheless, the Board appeared to take seriously the MPC's suggested incentive-based approach for adopting new technology and offered as one option a technology-specific approach "under which the Board would identify the paradigm-shifting technology(ies) that would reduce debit card fraud in a cost-effective manner. The adjustment would be set to reimburse the issuer for some of the costs associated with implementing the new technology, perhaps up to a cap…."[35] The Board noted "tokenization" and end-to-end encryption, in addition to chip-and-PIN, as such technologies.

Another Board-suggested option would be a "non-prescriptive approach," which would simply require an issuer to take "steps reasonably necessary" to maintain an effective fraud prevention program. This approach could permit reimbursement of some or all of existing fraud prevention costs (which the Board estimated from survey data to be 1.6 cents per transaction[36]), plus research and development costs of new technologies, again perhaps up to a cap.[37] The Board recognized however, that this alternative "would shift some or all of the issuers' on-going fraud-prevention costs to merchants, even though merchants already bear substantial card-related fraud prevention costs, particularly for signature debit transactions." [38]

Consequently, the Board requested that stakeholders respond to a series of questions that would help it focus on the appropriate solution, including whether, under the second option, fraud adjustments be allowed only for PIN debit transactions, due to their lower incidence of fraud. Significantly, the Board did not suggest that any portion of the adjustment flow to merchants to help reimburse their costs for transitioning to a new technology. However, it did request comment on why merchants should bear the

[35] 75 *Fed. Reg.* at 81742.
[36] Signature fraud prevention and data security costs were 2.2 cents per transaction and PIN debit costs, 1.2 cents per transaction. *Id.* at 81741 and n. 75.
[37] *Id.* at 81742.
[38] *Id.*

costs of fraud-reducing technologies that did not benefit them directly, e.g., by limiting the adjustment to technologies that would reduce fraud losses eligible for chargeback.

In sum, the ultimate rules for a fraud prevention adjustment remain wide open, potentially ranging from "none" to reimbursement for existing issuer costs, to reimbursement for costs of new fraud prevention technologies. Additional merchant comment and support may be needed to ensure that merchants receive appropriate financial recognition for costs they may bear in a transition to technologies that have a broader benefit in reducing fraud costs to all participants in the payment card process.

3. Limitations on Network Fees

a. What merchants suggested

All parties recognize the potential for networks to circumvent the limits imposed by the interchange fee standard by increasing fees, other than interchange fees, charged to merchants and acquirers and then directly or indirectly rebating those fees to issuers. Not only would the networks have the incentive to do so, but they have the ability to do so, through their practice of providing a broad range of incentives and discounts to issuers as the networks compete with one another for issuers' business. The Board estimates that these payments to issuers currently average two cents per transaction.[39] The potential for network fees as a vehicle for evasive conduct is not speculative: when the European Commission determined MasterCard's cross-boarder interchange fees to be unlawful and ordered a stop to their use, pending reform, "MasterCard revised its acquirer pricing structure in [Europe] which included increasing certain existing acquirer fees, introducing a new fee on acquirers, and repealing certain acquirer fee waivers. This raised the question of whether MasterCard has effectively been circumventing the prohibition in the Decision … and put in place measures having the same or equivalent object or effect."[40]

The MPC argued that, because of the difficulty of policing the broad range of multidirectional fund flows between networks and issuers, it was essential that the Board's regulatory solution "take a vigorous approach," in drafting rules implementing section 920(a)(8), to ensure that networks (and issuers) do not impose additional fees on merchants and acquirers as a means of evading or circumventing interchange fee limits. An effective approach would involve not only scrutiny of the flow of funds between the parties, but also assure that issuers did not attempt to adjust debit card features in an attempt technically to avoid coming under debit card fee limits. Such hybrid cards could include "decoupled" debit, in which the card issuer withdraws funds from an account held by another entity, or "deferred debit," which grants a temporary credit-like capability by deferring withdrawal of funds from a deposit account for a period of time.

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[39] *Id.* at 81725.

[40] European Commission, *Antitrust: Commissioner Kroes notes MasterCard's decision to cut cross-border Multilateral Interchange Fees and to repeal recent scheme fee increases—frequently asked questions*, MEMO/09/143, at 2 (Apr. 1, 2009).

b. What the Board proposed

Unfortunately, the Board's proposal seems less than optimal to prevent evasion through increases in network fees charged to merchants, with the increases rebated to issuers effectively as a supplement to interchange fees. Under the Board's proposed approach, networks would not fall afoul of the evasion prohibition even if their rebate and incentive payments paid to an issuer totally offset *all* of the fees an issuer paid the network for processing debit card transactions. Rather, a violation would occur only if the total rebates paid in connection with debit transactions were *greater* than the total debit card fees nominally owed to the network.[41]

Thus, the Board's approach could, in fact, permit circumvention of the Board's proposed interchange fee standard that excluded from the calculation of an issuer's recoverable ACS costs the processing fees it paid to networks. The Board expressly concluded that such an exclusion was necessary "because the Board recognizes that if network processing fees were included in allowable costs, acquirers (and by extension, merchants) might be in the position of effectively paying all network fees associated with debit card transactions."[42] But, under the Board's proposed anti-evasion rule, networks could achieve precisely this result by increasing network fees charged to merchants so as to generate revenues equal to the network fees it charged to issuers—and then use the funds to provide a rebate matching the fees issuers owed to networks.

On the other hand, the Board did recognize the potential for issuers to attempt to evade interchange fee limits by trying to fall outside the definitional boundary of "credit card." Thus, the Board included within the scope of "debit card" "deferred debit" and "decoupled debit" cards and solicited "comment on whether additional guidance is necessary that … similar products qualify as debit cards…."[43]

4. Limits on Issuer's and Network's Ability to Control Merchant Routing

a. What merchants suggested

Sections 920(b)(1)(A) and (B) prohibit, respectively, network arrangements that effectively restrict issuers to use of a single debit card network (or a single group of affiliated networks), and network and issuer arrangements that attempt to restrict merchants' ability to route debit transactions over any available card network. All sides agree that these provisions should increase competition among networks for merchant routing of debit transactions. The issue is how comprehensive the implementing regulations should be. One key question is whether there must be at least two non-affiliated networks for each method of authentication (signature and PIN) or just one of each. The MPC argued (consistent with Sen. Durbin's view) that there must be at least two unaffiliated networks, e.g., a Visa-branded signature debit card must also be able to

[41] 75 *Fed. Reg.* at 81747.
[42] *Id.* at 81735.
[43] *Id.* at 81729.

be authorized and cleared over a second signature debit network, such as Discover. At least two choices for PIN authorization would also be available. Similarly, merchants should be free to route a transaction over any available network and neither networks, acquirers, nor issuers could use contracts, incentive or volume discounts, etc., to incentivize parties in the processing chain to frustrate a merchant's choice.

b. What the Board Proposed

The Board made no preliminary decision regarding whether the "more than one network" requirement applied to authorization methods collectively, or to each authorization method, and asked for comment on the relative merits of each approach. In so doing, the Board noted that payment card networks increasingly have employed financial incentives for issuers to use the services of only one network and/or provide benefits the greater the share of the issuers' transactions that a card network carried. Signature networks currently may also limit the ability of an issuer to brand their card with more than one network logo.

The Board noted that additional expense might be needed to permit signature debit cards to operate over multiple networks, including changing merchant and acquirer routing tables. Also, networks might claim that customers would be confused if networks offered network-specific benefits if cardholders debit transactions were routed over the network.[44] Conversely, failure to require at least two networks for each type of authorization would severely limit the practical utility of merchants' statutory right to route transactions over the available network of their choice; in the case of a merchant without PIN acceptance capability, there would be no choice at all.[45]

Finally, however, the Board sought to assure that under whichever alternative the Board adopted, the merchant's preferences for routing must be given priority over any network or issuer preferences and to construe broadly the prohibitions on practices that "inhibit" a merchant's routing preferences. These prohibited practices include network or issuer rules that restrict a merchant's preference for the type of authorization to be used, rules that direct traffic to a particular network (except for default rules where there is no merchant choice), and rules restricting the method of authorization based on a cardholder's choice of access device, such as a contactless card.[46]

In short, the outcome of this rulemaking should have a significant impact on merchants not only by establishing the scope of merchants' ability to promote lower acceptance costs through network competition, but also, potentially, by encouraging card networks to focus on merchants as an-up-for-grabs customer base. If so, there may be greater interest in networks supporting merchants' promotional activities in return for the network's higher priority in merchant-directed routing tables.

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[44] *Id.* at 81749. It may be that implementation of a dual signature approach might shift networks' business approach, e.g., to provide cardholder benefit packages to issuers or merchants regardless of the network by which a transaction was processed.
[45] *Id.*
[46] *Id.* at 81752.

IV. The Justice Departments' Proposed Settlement with Visa and MasterCard Should Reinforce the Durbin Amendment's Promotion of Merchant Pricing Freedom

Section 920(b)(2) grants merchants limited "steering" rights with respect to their customer's choice of payment method, rights that are in effect today. More specifically, payment networks and their "members" (e.g., acquirers and issuers) may not directly or indirectly prevent a merchant from providing a discount or in-kind incentive[47] for payment by the use of cash, checks, or debit cards. However, with respect to incentives to use (or not to use) debit cards or credit cards, the incentives may *not* differentiate on the basis of the card issuer or the card network.

While the Durbin Amendment, as passed by the Senate, never permitted issuer-by-issuer incentives, the Amendment did permit merchants to offer incentives for customers to use one network's card compared to that of another network. However, this provision was eliminated in the House-Senate conference process. Sen. Durbin told his Senate colleagues that he much regretted this compromise and vowed to continue the effort to obtain for merchants the ability to steer their customers to lower costs networks.[48]

This objective was, in part, achieved on October 4, 2010, when the Justice Department's Antitrust Division, joined by the Attorneys General of several states (currently 18), filed suit against American Express, MasterCard, and Visa challenging each network's no-steering arrangements as agreements in restraint of trade in violation of the Sherman Act Section 1 in two markets: (1) the general purpose credit and charge card services market; and (2) a submarket "consisting of General Purpose Card network services provided to merchants in travel and entertainment businesses."[49] Simultaneously, Visa and MasterCard agreed to a consent settlement revising their anti-steering Operating Rules to permit inter-brand and intra-brand steering among credit card networks. This settlement is currently undergoing a notice-and-comment proceeding before Judge Garaufis in the Eastern District of New York.

Significantly, American Express did not settle with the Justice Department. Consequently, at present, those merchants who accept American Express cards, presumably including most participants in the hospitality industry, remain subject to the anti-steering and non-discrimination provisions that may be contained in their Amex merchant agreements.

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[47] Section 920(c)(4) defines "discount" in such a way as to preclude that term from meaning a pricing differential that increases a price above "the price that customers are informed is the regular price," e.g., a surcharge.
[48] 156 *Cong Rec.* at S5925 (July 15, 2010).
[49] *United States, et. al v. American Express Co., et. al.*, Civil Action No. CV-10-4496, (E.D.N.Y. Oct. 4, 2010), *Complaint* ¶ ¶ 34, 41.

If accepted by the District Court in its current form, the proposed settlement would grant merchants broad rights to incentivize customers to use the types of payment that a merchant prefers, including by credit or debit network brands. These rights include steering customers away from premium credit cards that carry higher interchange fees to standard credit cards that incur lower charges, and steering customers to PIN debit rather than signature debit.[50] Visa's and MasterCard's rules must be amended accordingly.[51]

However, the settlement permits networks to enter into agreements with merchants permitting exclusive or preferential arrangements for general purpose card acceptance (including with respect to co-branded or affinity cards) so long as (1) "any such agreement is individually negotiated with the Merchant and is not a standard agreement or part of a standard agreement generally offered by the Defendant to multiple Merchants;" and (2) is not imposed as a condition of acceptance of the network's general purpose cards.[52]

There are two practical limitations on the effectiveness of the proposed decree. First, as noted in comments filed with the Justice Department by one merchant group, it is necessary that visual and electronic means be available, at the point and time of sale, identifying a card's interchange classification so as to permit merchants to offer appropriate incentives/disincentives with respect to the card's use.[53] If the decree is not modified to ensure that such information is readily available at that time, merchants' ability effectively to take advantage of the rights obtained by the Justice Department would be lost. It remains to be seen whether and how concerns such as these will be taken into account by the Justice Department and the District Court as they consider approval of the proposed consent decree.

Second, it is not clear, as a matter of administrative simplicity and customer relations, whether merchants would be willing to offer a broad range of incentives reflecting payment type at the point of sale. A merchant's approach might depend on the merchant's assessment of the impact of payment costs on profit margins, the

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[50] More specifically, the proposed decree would require Visa and MasterCard to refrain from enforcing any rule, regulation or agreement restricting the ability of a merchant to offer discounts or other incentives to use one brand or "type" of general payment card or other "form of payment" in preference to other such cards or forms of payment. *Id.*, Proposed Final Judgment § IV(A). In so doing, the settlement makes clear that the reference to "type of card" includes "traditional cards, rewards cards, and premium cards," and the reference to "form of payment" permits differing incentives among "particular brands (e.g., Star, NYCE) or types (e.g., PIN debit) of debit cards or other means of payment." *Id.* §§ II(7), II(16).

[51] *Id.* §§ V(B), V(C).

[52] *Id.* § IV(B).

[53] *See* Retail Industry Leaders Ass'n, *Comments Concerning Proposed Final Judgment as to Defendants MasterCard International, Inc., and Visa, Inc.,* at 1-5 (Dec. 16, 2010).

sophistication of its point-of-sale systems, and its customer profiles and marketing strategy, including avoidance of customer confusion at the point of sale.

V. Hospitality Industry Counsel Must Remain Engaged In Regulatory, Legislative, and Courtroom Developments

A. The Legislative and Courtroom Challenges to the Durbin Amendment

As set out in Section III, the Board has taken substantial steps toward implementation of the Durbin Amendment in a manner designed to achieve the Amendment's objectives, but substantial areas remain subject to revision in comments received from stakeholders by the Board's comment deadline of February 22, 2011. These include:

- The scope of costs included as allowable costs under the interchange fee standard, and the level of caps and/or "safe harbors" the Board will adopt;
- Whether the Board will adopt a "fraud prevention cost" adjustment, and, if so, whether such an adjustment will create incentives for introduction of "paradigm-shifting" low-fraud authorization technologies;
- Whether the Board will adopt "anti-evasion" network fee rules that will be more effective than its current proposal; and
- Whether the Board will ensure that issuers must ensure that there are at least two payment networks available to process each method of debit card authorization from which merchants may choose.

Nevertheless, many in the financial industry claim that the Board's proposals have gone *too far* in allegedly favoring merchants over banks and card networks. And various senators and representatives—including both former Senator Dodd and Representative Frank—appear to have expressed some sympathy with this view.[54] And it is possible that legislative efforts will be made in the new Congress to delay the effective date of the Durbin Amendment rules or otherwise to modify the Board's potential approach. However, Sen. Durbin is committed to defending a strong regulatory outcome at the Board:

> At this point, I am hunkered down and ready for the fight that is coming. The biggest banks and credit card companies are going to do their best to influence

[54] See Wall Street Journal Online, *Chris Dodd's Exit Interview* (Dec. 20, 2010), http://blogs.wsj.com/washwire/2010/12/20/chris-dodds-exit interview/?KEYWORDS=Christopher+Dodd; Reuters Online, *Rep. Barney Frank critical of Fed debit card fee rule* (Dec. 17, 2010), http://www.reuters.com/article/idUSTRE6BF56220101217.

> the Federal Reserve to raise this interchange fee as high as possible, but we know what the reasonable costs are.[55]

Further, a lawsuit pending in federal court in South Dakota seeks to enjoin the Federal Reserve Board from implementing the Durbin Amendment on the grounds that: (1) the mandated incremental cost standard is a "ratemaking" that would result in fee levels so low as to result in a "confiscation" of the plaintiff bank's demand deposit and/or retail banking business in claimed violation of the Due Process Clause; (2) the existence of an exemption from interchange fee limits for financial institutions with less than $10 billion in assets violates the Equal Protection Clause; and (3) if it is within the constitutional power of Congress, implementation of mandated interchange fee restrictions would result in a regulatory "taking" of the plaintiff's demand deposit/retail banking business for which just compensation would be due.[56] A hearing on the plaintiff's motion for a preliminary injunction is scheduled for April 4. Substantial *amicus* participation is anticipated.

B. Hospitality Industry Counsel Should Actively Assist Their Clients in Taking Advantage of Merchants' Rights and Increased Negotiating Leverage

As the outcomes of these proceedings are clarified, hospitality industry participants should make sure they are positioned to implement any required changes in payment card processing procedures and to take advantage of cost savings opportunities and merchant's rights to steer their customers to the payment type of the merchant's choice. This process will require close interaction between corporate counsel and relevant marketing, vendor relations, and information technology staff to ensure effective and timely execution of implementation strategies. For example, merchants will have to make an assessment as to whether any benefits from steering will offset implementation costs and potential customer confusion or resistance at the point of sale.

Significantly for hospitality industry counsel, the collective impact of the Durbin Amendment regulations and the Justice Department's consent decree with Visa and MasterCard foreshadows potential Visa and MasterCard interest in negotiating preferred provider arrangements. This may particularly be the case if the final Durbin Amendment regulations require debit cards to carry two unaffiliated signature debit networks and two PIN networks.

Such preferred vendor relationships could be reinforced through the provisions of the Justice Department's proposed consent decree with Visa and MasterCard, discussed in section IV, that allow preferred vendor relationships that permit merchants to steer customers to the preferred networks so long as those provisions are individually negotiated and not part of a form contract unilaterally imposed as a precondition to card

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[55] 156 *Cong. Rec*. S10996 (Dec. 22, 2010).

[56] Complaint, *TCF National Bank v. Ben S. Bernanke et al.,* Case No. 4:10-cv-04149-LLP (D. S.D. Oct. 12, 2010).

acceptance. However a merchant's ability to take advantage of the settlement may be dependent on provisions in American Express merchant agreements that affect such rights.

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In short, the next several months will be crucial ones for hospitality industry counsel with clients concerned about the costs of payment card acceptance and/or interested in negotiating preferred vendor relationships with payment providers from a position of increased bargaining leverage. Thus, counsel need to ensure that their client's views continue to be heard both in the rulemaking process and with respect to any efforts in Congress to overturn Board actions that favor merchants rather than banks.

Hospitality industry counsel also need to keep abreast of developments in the courts with respect to approval of the Justice Department's settlement with MasterCard and Visa, and challenges to the constitutionality of the Durbin Amendment's interchange fee mandates. As the outcome of these proceedings becomes clearer, counsel should then engage with their clients to take advantage of resulting merchant rights and opportunities.