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If It Ain't Broke, Don't Fix It: Senator Durbin's Disastrous Solution to an Illusory Problem

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SENATOR DURBIN'S DISASTROUS SOLUTION TO AN ILLUSORY PROBLEM

INTRODUCTION

Under the spotlight and behind a podium stood the chairman of Coca-Cola, Robert Goizueta, ready to address a crowd of anxiously waiting spectators.[1] "'The best has been made even better,' he announced. . . . 'Simply stated, we have a new formula for Coke.'"[2] After opening the floor for questions, a journalist laconically asked, "Are you 100 percent certain that this won't bomb?"[3] Coca-Cola's intent was to revitalize its iconic drink through a revolutionary strategy, prompted by its eroding market share and a survey that illustrated the population's preference for a faintly sweeter cola.[4] Yet the journalist's words foreshowed an unforgiving array of consumer protest.[5]

In the spring and summer of 1985, consumers channeled their frustration through a colorful display of actions meant to denounce Coca-Cola's decision.[6] The company's phone line was targeted; at one point, it was flooded with 8,000 calls a day, in comparison to 400 prior to the formula change.[7] Consumer outrage eventually reached Mr. Goizueta himself, as one person wrote him seeking an autograph, stating that "in years to come, the signature of 'one of the dumbest executives in American business history' would be worth a fortune."[8] Consumers and musicians protested through the media, as the former poured "New Coke" down sewers on television and waived protest signs

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[1] Blair Matthews, *Coca-Cola's Big Mistake: New Coke 20 Years Later*, ARTICLESBASE (Dec. 2, 2008), http://www.articlesbase.com/marketing-articles/cocacolas-big-mistake-new-coke-20-years-later-666921.html.

[2] *Id.*

[3] *Id.*

[4] *Id.; see also The Real Story of New Coke*, COCA-COLA JOURNEY (Nov. 14, 2012), http://www.coca-colacompany.com/stories/coke-lore-new-coke.

[5] *The Real Story of New Coke*, *supra* note 4.

[6] *Id.*

[7] Matthews, *supra* note 1; *The Real Story of New Coke*, *supra* note 4.

[8] *The Real Story of New Coke*, *supra* note 4.

that read "We want the real thing" and "Our children will never know refreshment," and the latter composed nostalgic songs commemorating the traditional beverage.[9] Others expressed their concern through a less conspicuous avenue, as they resorted to hoarding the old product.[10] The firestorm from Coca-Cola's experiment quickly subsided when the original formula returned to the shelves two months later.[11]

Similarly, a formula change initiated by Senator Richard Durbin has impacted the "economics of offering a debit card," and is becoming the modern day version of Coca-Cola's strategic blunder.[12] The Dodd-Frank Wall Street Reform and Consumer Protection Act, an intricate statute responsible for regulating the comprehensive sectors of the United States financial system, was developed in response to the 2008 financial crisis.[13] The Dodd-Frank Bill was later amended to include Senator Durbin's eponymous Durbin Amendment (hereinafter Amendment), though he proposed it "at the 11th hour," and "[w]ithout committee hearings by either chamber of Congress."[14] The Amendment delegated the responsibility of contriving a system for the regulation of debit card interchange fees, or the fees that merchants pay to the bank each time a debit card is swiped, to the Federal Reserve Board (hereinafter Board or Fed).[15] The Amendment reflects the source of discord between merchants and financial institutions. The former group claimed that interchange fees were set at excessive levels, while the latter countered by arguing that they were set at a level proper to "serve the needs of all parties in the card system, including funding better consumer reward programs."[16] Prior to its

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[9] Matthews, *supra* note 1; *The Real Story of New Coke*, *supra* note 4.

[10] Matthews, *supra* note 1; *The Real Story of New Coke*, *supra* note 4.

[11] *See* Abbey Klaassen, *New Coke: One of Marketing's Biggest Blunders Turns 25*, ADVERTISING AGE (Apr. 23, 2010), http://adage.com/article/adages/coke-marketing-s-biggest-blunders-turns-25/143470/; *The Real Story of New Coke*, *supra* note 4.

[12] Ylan Q. Mui, *Bank of America Backs Off Debit Card Fee After Consumer Backlash*, WASH. POST (Nov. 1, 2011), http://www.washingtonpost.com/business/economy/bank-of-american-drops-debit-card-fee/2011/11/01/gIQADvugcM_story.html (internal quotation marks omitted).

[13] Brad G. Hubbard, The Durbin Amendment, Two-Sided Markets, and Wealth Transfers: An Examination of Unintended Consequences Three Years Later 2 (May 20, 2013) (working paper), *available at* http://ssrn.com/abstract=2285105.

[14] Richard A. Epstein, *The Dangerous Experiment of the Durbin Amendment: Congress' Interchange Fee Limit is a Reckless Exercise in Price Regulation*, CREDIT & BANKING 24, 24 (Spring 2011) *available at* http://object.cato.org/sites/cato.org/files/serials/files/regulation/2011/8/regv34n1-5.pdf.

[15] *Id.*

[16] Zhu Wang, *Debit Card Interchange Fee Regulation: Some Assessments and Considerations*, 98 ECON. Q. 159, 159 (2012), *available at* https://www.richmondfed.org/publications/research/economic_quarterly/2012/q3/pdf/wang.pdf.

implementation, the free market determined such fees,[17] but on July 20, 2011, in response to its mandate, the Board placed a cap on interchange fees that cut them, along with bank interchange revenue, by 55 and 50 percent, respectively.[18]

Consumers have displayed a robust surge of backlash in response to the endeavors that banks have taken as a result of the Amendment's regulations. To help minimize Amendment-induced losses, and salvage the debit card business, a collection of major financial institutions announced that a new fee was soon to replace a complimentary service for using a debit card.[19] Consumers voiced their discontent by harnessing the strength of social media. Molly Katchpole, a 22-year-old debit card owner, initiated an online petition in an attempt to overturn the fee's implementation.[20] Remarkably, it acquired 300,000 followers within 72 hours.[21] Likewise, a news anchor harnessed populist anger by cutting up her card during her broadcast. With a smirk of triumph, she ordered, "Chris, bring me my purse . . . give me that debit card" shortly before its shreds were spread out on the floor beneath her.[22] Finally, a hacktivist group targeted Bank of America's website to convey its displeasure.[23] Although the financial industry abandoned this vexing strategy, consumer frustration will linger until Congress stops making a scapegoat of the financial industry and takes a lesson from Coca-Cola by repealing Senator Durbin's ill-studied scheme[24]—returning to the free market system.

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[17] David S. Evans et al., Economic Analysis of Claims in Support of the "Durbin Amendment" to Regulate Debit Card Interchange Fees 30 (May 12, 2011) (working paper), *available at* http://ssrn.com/abstract=1843628 (click "Download This Paper").

[18] Hubbard, *supra* note 13, at 3; Peter Eavis, *Judge Rejects Fed's Cap on Debit Card Fees*, N.Y. TIMES DEAL B%K (July 31, 2013), http://dealbook.nytimes.com/2013/07/31/judge-rejects-feds-cap-on-debit-card-fees/; Richard A. Epstein, *The Dick Durbin Debit Card Fiasco*, HOOVER INSTITUTION (Aug. 6, 2013), http://www.hoover.org/research/dick-durbin-debit-card-fiasco.

[19] Tara Siegel Bernard & Ben Protess, *Banks to Make Customers Pay Fee for Using Debit Cards*, N.Y. TIMES (Sept. 29, 2011), http://nytimes.com/2011/09/30/business/banks-to-make-customers-pay-debit-card-fee.html?r=0.

[20] Molly Katchpole, *Who Battled Bank of America, Is In the Running For Time's 'Top 100'* HUFF POST (Mar. 29, 2012), http://www.huffingtonpost.com/2012/03/29/molly-katchpole-time-magazine_n_1387997.html.

[21] Mui, *supra* note 12.

[22] *BAC to Charge $5 for Debit Card Use*, FOX BUSINESS (Sept. 29, 2011), http://video.foxbusiness.com/v/1190993810001/bac-to-charge-5-for-debit-card-use/#sp=show-clips.

[23] Martha C. White, *Bank of America Backlash: Consumers React to Debit Card Fee*, TIME (Oct. 3, 2011), http://business.time.com/2011/10/03/bank-of-america-backlash-consumers-react-to-debit-card-fee/.

[24] *See* Epstein, *supra* note 14, at 24; Dan Fitzpatrick & Robin Sidel, *BofA Retreats on Debit Fee, Citing Uproar*, WALL ST. J. (Nov. 1, 2011, 6:13 PM), http://online.wsj.com/news/articles/SB10001424052970204528204577011813902843218.

In addition to the resulting populist anger, the interchange cap prompted a panoply of courtroom battles between merchants and financial institutions. After the interchange cap withstood a constitutional challenge by TCF National Bank (hereinafter TCF),[25] a financial institution regulated by the Amendment, U.S. District Court Judge Richard Leon overturned it. In response to a lawsuit initiated by a plethora of retailors in mid-2013, Judge Leon's lambasting opinion ordered the Board to decrease the interchange cap even further because it failed to abide with Congress's intent and the language of the Amendment.[26] However, the Board challenged the judgment[27] and, in the following year, the U.S Court of Appeals for the District of Columbia contributed to the Amendment's saga by reversing Judge Leon's ruling, and thus salvaging the Board's initial interchange cap.[28]

Although the appellate court mitigates the harm of Judge Leon's decision, its ruling should not be viewed as a victory for the banking industry, or even as a balanced compromise between merchants and financial institutions, because it fails to rectify the glut of deficiencies that have spawned since the Amendment's implementation. This note will reveal these shortcomings by analyzing the Amendment through an economic, empirical, and constitutional framework. Specifically, this note will argue that the Amendment should be repealed because of its detrimental impact on consumers and small businesses through increased costs, and its encroachment upon the banking industry's ability to operate a profitable debit card business.

Part I of this note provides a rudimentary explanation of the debit card industry, discussing its key parts and functions, and its various fees and purposes. Part II describes the debit market's two-sided economic framework that served as the catalyst for debit's popularity, and paints an overview of pre-Amendment, interchange fee trends. With that in mind, Part III explains how the Amendment distorts the aforementioned economic framework through its objectives, major regulations, and exemptions, while shedding light on the pitfalls of international interchange regulation in order to reveal the unintended consequences of the Amendment's implementation upon small businesses and consumers. Part IV summarizes the

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[25] TCF Nat'l Bank v. Bernanke, 643 F.3d 1158, 1161 (8th Cir. 2011).

[26] *See* NACS v. Bd. of Governors of Fed. Reserve Sys. 958 F. Supp. 2d 85, 86-87 (D.D.C. 2013).

[27] *See* NACS v. Bd. of Governors of Fed. Reserve Sys., 746 F.3d 474 (D.C. Cir. 2014).

[28] *Id.*

legal battles that have ensued since the Amendment's application and the constitutional deficiencies that have yet to be properly addressed under the U.S. Constitution's confiscatory rate doctrine. Finally, this note concludes with a solution that advocates for the revocation of the Amendment because of the inimitable efficiency of an interchange fee set by the free market system.

I. THE RUDIMENTS OF THE DEBIT CARD INDUSTRY

A. The General Forms of Debit Systems

Currently, there are two distinct payment systems that are generally utilized to clear all debit card transactions, "often referred to as three-party and four-party systems."[29] The former model primarily handles the authorization of prepaid card transactions.[30] The latter model supports the preponderance of debit card transactions.[31] However, the four party system is slightly misleading because it comprises five groups: (1) the consumer, who supplies the debit card as a form of payment; (2) the issuing bank, which provides the consumer with a debit card and a bank account; (3) the merchant, who receives the debit card as payment; (4) the acquiring bank, which processes the debit card payment for the merchant; and (5) the network—Visa, MasterCard, and Discover.[32] The network serves as the nucleus by equipping the issuing and acquiring groups with the framework required to route the entire process.[33]

The process begins, for example, when the consumer provides a Bank of America-issued Visa debit card to purchase a product from one of Apple's retail stores.[34] After the card is swiped through a card reader, an electronic message containing information about the dollar value of the purchase is created.[35] Apple (the merchant) then relays this message to the financial institution that manages its Visa transactions (acquiring bank).[36] From there, it is forwarded on to the network, in this case Visa.[37]

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[29] Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43394, 43395 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235).

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

[31] *Id.*

[32] *NACS*, 958 F. Supp at 87-88.

[33] *Id.* at 88.

[34] DAVID S. EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING (2d ed. 2005).

[35] *Id.*

[36] *Id.* at 10.

[37] *Id.*

After the message is read, Visa conveys it to the consumer's issuing bank, where Bank of America determines if there are enough funds for the purchase.[38] If there are sufficient funds, Bank of America returns an authorization message via the converse route where it is first received by Visa.[39] The authorization message is then sent back to Apple's acquirer, who forwards it to Apple.[40] A receipt is printed, and the transaction is complete, usually within seconds.[41] The cost of the transaction is deducted from the consumer's debit account and credited to Apple's account, minus specific costs linked with the routing process.[42]

B. Transactional Fees and Interchange's Role

The various costs accompanying debit card transactions that the merchant must pay include: (1) the interchange fee, which is received by the issuing bank; (2) the network fee, which is received by the network processing the transaction, and (3) the merchant discount, which is sent to the merchant's acquiring bank.[43] The Amendment only regulates the interchange fee, which is the largest fee that merchants incur after a debit card transaction.[44] Since it would be "a transactional nightmare" if each issuing bank negotiates the terms of the interchange fee with each individual merchant, the networks set the fee level.[45] Crucially, the method of network-established interchange fees was considered essential by the Eleventh Circuit in holding that "the [interchange fee] on balance is procompetitive because it was necessary to achieve stability and thus ensure the one element vital to the survival of the [network] system—universality of acceptance."[46]

Unlike debit cards, checks clear at par, or for free, when they are provided as a form of payment though both forms work analogously.[47] When using either method, the issuing bank does

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[38] *Id.*

[39] Robin A. Prager et al., Fed. Reserve Bd., *Interchange Fees and Payment Card Networks: Economics, Industry Developments, and Policy Issues* 10 (Fin. & Econ. Discussion Series Working Paper No. 2009-23, 2009), *available at* http://www.federalreserve.gov/pubs/feds/2009/200923/200923pap.pdf.

[40] EVANS & SCHMALENSEE, *supra* note 34, at 10.

[41] *Id.*

[42] PRAGER, *supra* note 39, at 11.

[43] *Id.* at 11-12.

[44] Fumiko Hayashi, *The New Debit Card Regulations: Initial Effects on Networks and Banks*, 2012 FED. RES. BANK OF KANSAS CITY ECON. REV. 79, 85 (2013), *available at* http://www.kansascityfed.org/publicat/econrev/pdf/12q4Hayashi.pdf .

[45] Epstein, *supra* note 14, at 26; Hubbard, *supra* note 13, at 6.

[46] Nat'l Bancard Corp. v. VISA, 779 F.2d 592, 605 (11th Cir. 1986).

[47] Hubbard, *supra* note 13, at 8.

not face any credit risk, as the necessary funds are acquired directly from the consumer's account.[48] Nonetheless, the interchange fee was not developed merely to burden merchants. Rather, merchants pay it in exchange for the many benefits that checks, or cash, do not provide. These benefits include "guaranteed payment (that is, the elimination of 'bad' . . . checks); 'ticket lift,' which is a proven increase in sales observed when consumers pay via card rather than check or cash; and lower labor costs through a reduction in transaction time."[49]

The most essential of these benefits might be guaranteed payment, because when a check is used as the method of payment, the merchant stomachs the risk of default—if the funds in the consumer's account are insufficient, the shortage falls on the merchant.[50] In contrast, when a debit card is used, the risk of loss shifts from the merchant to the issuing bank.[51] This exchange is preferred because banks, as opposed to merchants, are familiar with the cardholder's account.[52] Similarly, the same advantages are realized when analogizing cash and debit as methods of payment. Not only does debit eliminate the risk of counterfeit money, it also minimizes the possibility of theft by employees or intruders because debit reduces the amount of cash on a business's premises.[53] The success of these benefits is punctuated by the fact that some merchants only accept credit or debit as forms of payment, as opposed to cash or check.[54] The efficiencies that accompany debit card payments elucidate why merchants pay interchange fees, even though checks clear at par.

Additionally, credit card interchange fees are endogenous because they are used entirely to cover the costs associated within the system, while debit card interchange fees are exogenous.[55] Though issuers could retain these fees, and improve their bottom lines, they generally use them to subsidize consumer checking accounts, which "facilitate[s] broader penetration of mainstream checking account services

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[48] *Id.*

[49] *Id.* (quoting Patrick C. McGinnis, *Misguided Regulation of Interchange Fees: The Consumer Impact of the Durbin Amendment*, 25 LOY. CONSUMER L. REV. 285, 289 (2013)).

[50] *Id.* at 9.

[51] *Id.*

[52] *Id.*

[53] *Id.*

[54] *Id.*

[55] *Id.* at 10.

to low- and middle-income populations."[56] Additionally, these fees are used to fund reward programs and debit cards—there are no usage fees for having a debit card.[57]

II. An Economic Framework That Led to the Proliferation Of Debit

A. *Debit's Two-Sided Market*

Regardless of the mutual benefits that both merchants and consumers experience, Senator Durbin conjectured that the debit card industry was plagued because interchange fees were unrelated to the costs of providing a debit card service.[58] The Senator's conclusion, however, overlooks the fact that the debit market is two-sided:

> Every card transaction necessarily involves two users: a cardholder and a merchant. Cardholders benefit from their holding a card only if their cards are accepted by a wide range of merchants, and merchants benefit from the card only if a sufficient number of consumers use it. Therefore, it is reasonable for the card network to price differently to cardholders and merchants in order to effectively balance the demand on the two sides of the market.[59]

That is, disparate pricing is not an indication of lopsided competition or collusive pricing, as Senator Durbin suggests. Rather, it is a sign of an efficient market.[60] Unlike an ordinary market, where "each buyer and seller goes about his business without caring whether or not other traders succeed or fail," both sides of a two-sided market rely upon each other; "the ability to satisfy one side of the market depends on the continued participation of the other."[61] For that reason, the intermediary, or the relevant network, must permit the side that is less elastic, or less sensitive to an increase in price, to cross-subsidize the side that is more elastic, or more sensitive

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[56] Ronald J. Mann, *Anticompetitive Regulation in the Payment Card Industry*, 7 COMPETITION POL'Y INT'L 44, 51 (2011), *available at* http://www.columbia.edu/~mr2651/Anticompetitive_Regulation_in_the_Payment_Card_Industry.pdf.

[57] Hubbard, *supra* note 13, at 7.

[58] *See id.* at 2.

[59] James McAndrews & Zhu Wang, *The Economics of Two-Sided Payment Card Markets: Pricing, Adoption and Usage* 2 (Fed. Reserve Bank of Richmond, Working Paper No. 12-06, Sept. 2012), *available at* https://www.richmondfed.org/publications/research/working_papers/2012/pdf/wp12-06.pdf.

[60] Hubbard, *supra* note 13, at 25.

[61] Epstein, *supra* note 14, at 26.

to an increase in price.[62] The following illustration helps explain this phenomenon:

> [A] traditional singles bar that only attracts male patrons would quickly go out of business. As an empirical matter, it is far easier to get men to attend singles bars than women, implying that a uniform price for drinks for all customers results in an excess of males, at which point the market can collapse. What is needed is to find a cost-effective way for the men to subsidize the purchase of women's drinks.[63]

Two-sided markets help remedy this enigma. Charge the less elastic patrons, or the males, greater than the more elastic patrons, or the females, for drinks.[64] So long as the aggregate prices paid by both groups surpass the bar's cost of operation, this example of price discrimination will increase the welfare of both sides of the market, and allow the bar to operate—the discounted price will attract women and that, in turn, will attract men.[65]

The debit card market presented a similar problem, but on a more complex scale. Before debit's prevalence, both sides of the market were missing—consumers did not use debit cards and merchants did not accept them.[66] Naturally, neither side desired to act as the "guinea pig" because using a card that isn't accepted and accepting a card that isn't used is futile.[67] The networks, or the intermediaries, provided a crucial solution to this problem: "to incentivize merchants to install card readers, Visa charged merchants [or the less elastic side] above the costs of providing the interchange service to them."[68] Though counterintuitive, the banks, who were the recipients of the excess revenue, harnessed it to entice consumers through the form of free debit service and rewards programs.[69] These benefits fostered consumer switching, as customers began paying with debit, as opposed to cash and check.[70] In turn, the network's value increased for merchants, as they were receiving more efficient means of payment.[71] By setting different prices, the networks created a feedback loop that mutually benefited merchants and consumers, thus incentivizing both sides to participate and remain in the debit card market. This explains

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62 Hubbard, *supra* note 13, at 24.
63 Epstein, *supra* note 14, at 26.
64 *Id.*
65 *Id.*
66 Hubbard, *supra* note 13, at 24.
67 *Id.*
68 *Id.*
69 *Id.*
70 *Id.*
71 *Id.*

why the costs of the debit system aren't divided evenly among merchants and consumers, and why the prices paid by the merchants do not reflect the costs of the provided service.

B. Debit's Pre-Amendment Popularity and Interchange's Trend

The proliferation of debit card usage that ensued was not fortuitous; rather, debit's two-sided market provided the networks with a vehicle for enabling debit's impressive market penetration. In fact, "debit cards have been the fastest growing payment method among non-cash, retail payment methods."[72] By the end of the 20th century, debit card usage represented around 11.6 percent of all noncash payments.[73] Yet debit card usage flourished between 2000 and 2009, increasing from 8 billion to 38 billion transactions.[74] By 2009, debit cards outpaced their credit card and paper check counterparts, and "became the most common form of payment, whether measured by dollars or by number of transactions."[75] Similarly, "[d]ebit's household penetration has also been extensive; in 1995 only 20 percent of households had debit cards; by 2007, that number had increased to 71 percent."[76]

Debit's preeminence amid noncash payment methods and its incontrovertible popularity have not caused interchange fees to escalate over the years.[77] Though Senator Durbin believes that networks "have incentive to constantly increase interchange rates . . . [because] . . . [t]here is no naturally-occurring market force in today's interchange system that would ever lead rates to go down," interchange data says otherwise.[78] As the Federal Reserve has identified, "there was no material increase in interchange fees between 2005 and 2009."[79] Rather, they were diminishing: "[T]he weighted average debit interchange fee declined by about 20 percent over the [2000s] and the weighted average debit interchange fee has

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[72] Hayashi, *supra* note 44, at 81.

[73] Patrick C. McGinnis, *Misguided Regulation of Interchange Fees: The Consumer Impact of the Durbin Amendment*, 25 LOY. CONSUMER L. REV. 285, 290 (2013).

[74] Hubbard, *supra* note 13, at 10-11.

[75] Richard A. Epstein, *Durbin's Folly: The Erratic Course of Debit Card Markets*, 7 COMPETITION POL'Y INT'L 58, 60 (2011).

[76] Hubbard, *supra* note 13, at 11.

[77] Evans, *supra* note 17, at 16.

[78] *Id.* at 15.

[79] Hubbard, *supra* note 13, at 11.

been roughly constant since 2004."[80] Moreover, the risk of a snowballing rate effect is irrational because the networks "compete with each other vigorously in every market in which they operate" and collusive pricing is prohibited by the traditional antitrust laws.[81]

III. AN OVERVIEW OF THE AMENDMENT AND ITS UNINTENDED CONSEQUENCES

A. *The Amendment's Misguided Objectives and Regulations*

Notwithstanding interchange's downward trend, Senator Durbin sought to reform an already well-functioning market by transferring the costs of debit programs from the merchant to the cardholder. The effect of which has dismantled the network's feedback loop, and compels consumers, the more elastic side, to cross-subsidize merchants, the less elastic side. Senator Durbin has glossed over this economic inefficiency by emphasizing the Amendment's goal of "reliev[ing] merchants from high interchange fees, which would, in turn, enable merchants to pass these cost savings on to consumers, who would see lower retail prices."[82]

Though debit cards are subject to the Amendment's less controversial regulations,[83] the Amendment's cardinal provision purportedly achieves this goal by ordering the Board to create a ceiling for interchange fees.[84] Senator Durbin vindicates this price regulation by underscoring the success of interchange control in Canada,[85] although its market is easily distinguishable from that of the American debit card market. Rather, an analysis of Australia's results with interchange fee regulation is fitting, due to the substantial similarities between Australian and American

[80] *Id.* (quoting Evans, *supra* note 17, at 16-18.)

[81] Epstein, *supra* note 14, at 28.

[82] Hubbard, *supra* note 13, at 3.

[83] *Id.* at 15-16. The Amendment has two additional regulations worth mentioning. First, the Amendment permits merchants to offer discounts, based on payment methods, and to set a minimum price for accepting cards, not exceeding $10. *Id.* at 16. The Amendment's second regulation requires a concise overview of the two predominant types of debit card processing: Personal Identification Number (PIN) and signature. *Id.* at 14. To authorize a debit transaction, the former method requires the consumer to enter a PIN number, and the latter method requires the consumer to sign a receipt. *Id.* Currently, Visa, MasterCard, and Discover each own one of three signature networks. *Id.* at 15. Consequently, the Amendment requires networks to allow merchants to select between two or more independent and competing payment networks. *Id.*

[84] 15 U.S.C § 1693*o*-2(a)(1)-(2) (2012).

[85] Evans, *supra* note 17, at 20-21.

regulations.[86] The identical pitfalls that are developing within both countries corroborate simple economic theory: "price controls have unintended, and unwelcome, consequences."[87]

1. The Cap on Interchange Fees

The vast display of economic consequences that have emerged since the implementation of the Amendment derive from its most vexing provision, which regulates the price of interchange fees. Interchange fees are defined as "any fee established, charged or received by a payment card network for the purpose of compensating an issuer for its involvement in an electronic debit transaction."[88] Although the Amendment orders the Board to fix them at a level that is "reasonable and proportional to the cost" of a debit transaction,[89] the Amendment does provide some guidance by stipulating which costs to consider and which to disregard. Specifically, the Board must differentiate between "(i) the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction . . . ; and (ii) other costs incurred by an issuer which are not specific to a particular electronic debit transaction."[90] The text's plain language insinuates that, in setting a cap, the Board should consider the marginal costs of each debit transaction, and disregard the fixed or sunk costs associated with the business, leaving them unsalvageable.[91] In response, the Board decided to institute "a safe harbor for interchange fees; any fee set at or below the Fed's safe harbor is presumptively reasonable."[92] Specifically, "[t]he safe harbor was set as a two-part tariff; there is a flat cap of $0.21 per transaction in addition to an allowable 5 basis points (0.05%) of the transaction value (and an additional cent allowed for fraud protection)."[93]

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[86] *See* Hubbard, *supra* note 13, at 42.

[87] Epstein, *supra* note 75, at 59.

[88] 15 U.S.C. § 1693*o*-2(c)(8).

[89] *Id.* § 1693*o*-2(a)(2).

[90] *Id.* § 1693*o*-2(a)(4)(B).

[91] Hubbard, *supra* note 13, at 13.

[92] *Id.*; Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43394, 43404 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235).

[93] Hubbard, *supra* note 13, at 13 (citations omitted); Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43404.

2. Small Bank Exemption

However, "small banks," defined as "those with less than $10 billion in assets," are exempt from the regulations' interchange fee cap.[94] Specifically, the exemption allows 99 percent of banks, or approximately 14,500 institutions, to escape from the Amendment's reach.[95] This two-tiered system provides small banks with a competitive advantage. For example, small banks can exploit the pre-Amendment interchange fees they receive, and lure consumers from regulated banks, by continuing to provide and enhance their debit card rewards programs.[96] Although the Amendment may seek to encourage consumer switching, it creates an economic problem that could culminate in a deficient banking system because larger banks are more proficient than small banks:

> A two-tiered interchange system . . . will create distortions and promote inefficient bank operations . . . [T]hese [exempt] institutions are likely small because they are relatively inefficient and have higher costs. If customers switch from large banks to smaller, less efficient ones, there will be harm to competition and consumers. . . . The result will be a less efficient banking system.[97]

Accordingly, the inefficiencies that result from the Amendment's small bank exemption swallow the potential gains that derive from the carve out, because of the cost advantages that large banks have developed.

B. An Analysis of Foreign Interchange Fee Regulation

1. Canada is a Misleading Indicator of Interchange Fee Regulation

Senator Durbin disregards this concern, and validates the Board's interchange ceiling by highlighting the results of interchange control abroad: "Do you know what the interchange fee is in Canada? It is zero," and it "enjoy[s] vibrant debit systems."[98] Notwithstanding the fact that Canada and America vary in a "number of ways that influence the economics of the

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[94] 15 U.S.C § 1693(a)(6); Hubbard, *supra* note 13, at 17. However, small banks are subject to the Amendment's less controversial provisions. *Id.*

[95] Epstein, *supra* note 14, at 24; Hubbard, *supra* note 13, at 18.

[96] Hubbard, *supra* note 13, at 19.

[97] *Id.* (quoting Report of Kevin M. Murphy at 41, TCF Nat'l Bank v. Bernanke, 643 F.3d 1158 (8th Cir. 2011) (No. 10-4194), 2011 WL 863916).

[98] Evans, *supra* note 17, at 20-21.

debit card business,"[99] Senator Durbin and other proponents of the Amendment overlook substantial differences between the debit cards offered by the banks of each country.[100] For example, Canadian banks issue debit cards that are incapable of making online purchases.[101] Citizens of Canada "cannot use their debit cards to buy books on Amazon, play games on Facebook, buy applications on their smart phones, or to pay . . . on the Internet . . . ."[102] Instead, they have to rely on credit cards or other payment methods for these types of purchases.[103] American debit cards, on the other hand, are capable of making online purchases.[104] Additionally, "[u]ntil 2004, Canadian consumers could use their cards only to pay in Canada."[105] Recently, Canadian debit cards became functional at some merchant locations in the United States, but not in any other countries.[106] Contrastingly, American debit cards are practically operable across the globe.[107] Such sharp distinctions between each country's regulated product make Canada a poor model for the American debit payment process.

2. The Dire Effects of Australian Interchange Fee Regulation

Rather, the proper gauge of interchange regulation is Australia, as their debit cards and regulations mirror those in America.[108] A review of Australia's decade-long intervention exhibits several undesirable consequences. First, interchange regulation has curtailed bank ingenuity, as the "adoption of new technology slowed and innovation was stifled" due to a decreased debit revenue stream.[109] Second, the figures show "that merchants benefitted enormously, while consumer[s] have paid the price" as "[b]anks began charging consumers periodic (annual) account fees, checking account fees, per-transaction fees, and reward program-based fees."[110] Third, "there has been no evidence that merchants passed their

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[99] *Id.* at 22 n.47.
[100] *Id.* at 22.
[101] *Id.* at 22-23.
[102] *Id.* at 22.
[103] *Id.*
[104] *Id.*
[105] *Id.* at 23.
[106] *Id.* at 22.
[107] *Id.*
[108] Hubbard, *supra* note 13, at 42.
[109] *Id.* at 44.
[110] *Id.* at 43

savings on to consumers."[111] While merchant profits have increased from the reduction of interchange costs,[112] consumers have felt the repercussions of such regulation as banks have limited their investment in a valuable product and pushed losses onto the consumer through the form of increased fees.

C. An Analysis of American Interchange Fee Regulation

1. The Harm to Consumers

Similarly, since the Amendment's inception, the side effects of American interchange regulation mirror those of its foreign counterpart, as the Amendment's repercussions have indirectly affected consumers—or the Amendment's first intended beneficiary—by curtailing bank "incentive (and ability) to invest [in] innovation."[113] As mentioned, the "'revenues collected from interchange fees are not merely profits for banks, but rather they fund ma[n]y of the programs and benefits customers receive,' including fraud prevention and customer authentication in particular."[114] Hence, consumers naturally saw "less innovation in areas such as risk management, security, loyalty programs, product development, and user education due to the limited capital available for investment."[115]

Additionally, like Australian banks, American banks have endeavored to push their Amendment-induced losses onto the consumer because the *TCF National Bank* court concluded that, by charging consumers for debit card usage, financial institutions could "offset any losses under the Durbin Amendment."[116] However, after failing to institute monthly debit fees, banks' instead increased fees for other services that have not triggered customer sensitivities, though such action will not provide issuing banks with the proper rate of return crucial to recover their costs of operations and produce a profit.[117] Nonetheless, consumer checking account rates have escalated between 21 and 25 percent from pre-Amendment rates.[118] Further, free checking is becoming a rarity: "In 2009,

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[111] *Id.*
[112] *Id.*
[113] *Id.* at 31.
[114] *Id.* (quoting McGinnis, *supra* note 73, at 303).
[115] *Id.*
[116] TCF Nat'l Bank v. Bernanke, 643 F.3d 1158, 1164 (8th Cir. 2011); *see also* Hubbard, *supra* note 13, at 27, 38-40.
[117] Epstein, *supra* note 14, at 28-29.
[118] Hubbard, *supra* note 13, at 39.

96 percent of large banks offered some form of free checking; by 2011, this number had dropped to 24 percent."[119] Finally, banks gutted or discontinued their debit card rewards programs: "In 2011, 54 percent of banks were restructuring or terminating their rewards programs."[120]

Perhaps most frustratingly, like Australian consumers, American consumers have not benefited at the point of sale, although "[a]s part of their lobbying tactics, giant retailers promised to lower prices for their customers if Congress passed the Durbin [A]mendment."[121] Instead, retailers are clinging onto their "$8 billion annual windfall" derived from reduced interchange fees, while consumers have yet to see any savings.[122] Additionally, consumer outlook appears grim, as a recent survey disclosed "that only 3 percent of retailers intended to pass any savings on to consumers, while 41 percent said they have no plans to pass on lower prices to consumers at all, and the other 56 percent are unsure."[123]

2. The Harm to Small Businesses

Nevertheless, the Amendment has not benefitted all merchants. American interchange regulation has spawned a new symptom that our Australian counterpart has not experienced: harm to small businesses—the Amendment's second intended beneficiary.[124] Though counterintuitive, interchange fees for small businesses, such as taxicab operators, quick service restaurants, and coffee shop owners, have risen.[125] Pre-Amendment, Visa and MasterCard provided a small business discount for merchants that relied on low-cost transactions, as a way of enticing them to accept debit.[126] However, because the networks have responded to the regulation by extinguishing the low-cost transaction discount, small businesses are required to pay the maximum ceiling that

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[119] *Id.* at 40 (internal citation omitted).

[120] *Id.*

[121] *The Durbin Effect: Two Years Later Consumers Not Benefitting from Durbin Price Control Regulation*, ELECTRONIC PAYMENTS COALITION, http://wheresmydebitdiscount.com/the-durbin-effect (last visited May 19, 2013) (internal quotation marks omitted).

[122] *Id.* (internal quotation marks omitted).

[123] Hubbard, *supra* note 13, at 37 (quoting MASTERCARD WORLDWIDE, INTERCHANGE AND THE DURBIN AMENDMENT, *available at* http://www.mastercard.com/us/company/en/docs/Interchange_and_Durbin.pdf (last visited Oct. 3, 2014) (internal quotation marks omitted)).

[124] *Id.* at 33.

[125] Wang, *supra* note 16, at 169 n.19.

[126] *Id.* at 169.

the Amendment permits ($0.21 plus 0.05% of the transaction).[127] Consequently, most transactions under $11 are now exposed to higher interchange fees; "[f]or merchants selling small-ticket items, this means that the cost of accepting the same debit card doubled or even tripled after the regulation."[128] The egregiousness of this effect is punctuated by the Merchants Payments Coalition, as the retailer conglomerate that supported the Amendment stated: "The fact that the rule let swipe fees increase on many small-dollar transactions makes no sense . . . ."[129]

IV. THE CONSTITUTIONAL DEFICIENCIES OF THE DURBIN AMENDMENT

The confiscatory rate doctrine, which stems from the Takings Clause of the Fifth Amendment, is the primary vehicle for attacking regulatory rates that cause dire economic inefficiencies.[130] The Supreme Court's analysis of a plethora of ratemaking cases has revealed that a regulatory scheme is not confiscatory if it dictates rates that permit a supplier to recoup its actual cost of service, in addition to a fair profit.[131] Therefore, a statutory regulation would violate the confiscatory rate doctrine if either of the following occurred: (1) the regulation is set at a level that prevents the issuer from recouping a reasonable profit margin, or (2) the regulation impedes the issuer from recovering its entire costs of providing the service at issue.[132]

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[127] *Id.*

[128] *Id.*

[129] Kevin Woodward & Kim Daly, *Appellate Court Upholds the Fed's Rule Implementing the Durbin Amendment*, DIGITAL TRANSACTIONS (Mar. 21, 2014) http://www.digitaltransactions.net/news/story/Appellate-Court-Upholds-the-Fed_s-Rule-Implementing-the-Durbin-Amendment.

[130] John N. Drobak, *Constitutional Limits on Price and Rent Control: The Lessons of Utility Regulation*, 64 WASH. U. L. REV. 107, 109 (1986); Epstein, *supra* note 14, at 29; Brief of Petitioner-Appellant at 20, 27, TCF Nat'l Bank v. Bernanke, 643 F.3d 1158 (8th Cir. 2011) (No. 11-1805).

[131] *See, e.g.*, *In re* Permian Basin Area Rate Cases, 390 U.S. 747, 770 (1968); Fed. Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944); Fed. Power Comm'n v. Natural Gas Pipeline Co., 315 U.S. 575, 585-86 (1942); Amended Complaint at 28-29, TCF Nat'l Bank v. Bernanke, No. 10-04149 (D.S.D. Jan. 27, 2011), 2011 WL 864074; Brief for the Clearing House Ass'n et al. as Amici Curiae Supporting Petitioners at 12, TCF Nat'l Bank v. Bernanke, 643 F.3d 1158 (8th Cir. 2011) (No. 11-1805); William P. Barr et al., *The Gild That is Killing the Lilly: How Confusion Over Regulatory Takings Doctrine is Undermining the Core Protections of the Takings Clause*, 73 GEO. WASH. L. REV. 429, 465 (2005).

[132] Brief for the Clearing House Ass'n et al., *supra* note 131, at 10-11.

A. *The Amendment's Implementation Sparks Numerous Courtroom Battles*

In reliance on these principles, TCF challenged the Amendment's constitutionality under the Takings Clause of the Fifth Amendment.[133] Specifically, the bank argued that the regulation was confiscatory because it not only eviscerated debit card interchange fee revenues, but also mandated rates that prevented an issuing bank from recovering the necessary costs associated with the debit card business.[134] Striving to avoid interchange rates that were not compensatory, TCF moved to enjoin the Amendment, though the U.S. District Court for the District of South Dakota denied the petition.[135]

The Eighth Circuit upheld the district court's decision, reasoning that TCF, and other financial institutions, were not entitled to the protections of the confiscatory rate doctrine.[136] The crux of the court's analysis is captured by two deceivingly concise statements: "TCF's offering of debit cards is not required by the government . . . . [l]ikewise, there is no monopoly power assumed to be associated with issuing debit cards."[137] Particularly, the court refused to apply the confiscatory rate doctrine because: (1) issuing banks are free to abandon their business of providing debit card services; and (2) issuing banks lack the characteristics of public utilities, or companies that have been granted a natural monopoly subject to government control.[138] Rather, the court reasoned that the appropriate level of scrutiny was the highly deferential rational basis review, which upholds government action "if there is any reasonably conceivable state of facts that could provide a rational basis for the clarification," even if it compromises an issuing bank's financial integrity by leaving it with a return that is non-sustainable.[139] Congress's intention "to ensure that such fees are reasonable and . . . to prevent retailers and consumers from having to bear" the burden of the debit card system satisfied this test.[140] TCF's constitutional arguments were at a standstill.

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133 Brief of Petitioner-Appellant, *supra* note 130, at 4.

134 *Id.* at 14, 17.

135 TCF Nat'l Bank v. Bernanke, No. CIV 10-4149, 2011 WL 1578535, at *1 (D.S.D. Apr. 25, 2011).

136 TCF Nat'l Bank v. Bernanke, 643 F.3d 1158, 1161, 1164 (8th Cir. 2011).

137 *TCF Nat'l Bank*, 2011 WL 1578535, at *4.

138 *Id.*

139 *Id.* (quoting Heller v. Doe, 509 U.S. 312, 319-20 (1993)) (internal quotation marks omitted).

140 *TCF Nat'l Bank*, 2011 WL 1578535, at *4.

Two years later, Judge Leon reignited the Amendment's controversy in *NACS v. Federal Reserve*, where he ordered the Board to slash the debit interchange fee below the 21 cents-per-transaction rate that it authorized in 2011.[141] In this case, the NACS, a trade association representing over 3,700 businesses, claimed that the statutory cap was too high, and brought suit against the Board.[142] In his opinion, Judge Leon purported that, in construing the cap, the Board had run "completely afoul of the text, design and purpose" of what Congress had intended.[143] He noted that the Board's statutory cap ignored the plain language of the statute, because the cap accounted for debit card costs that were prohibited by it.[144] Merchants applauded as Judge Leon's interpretation of the statute required the Board to issue new rates between three and six cents per transaction.[145]

On appeal, Judge Tatel penned an opinion that reversed the lower court's ruling, and confirmed the validity of the Board's original interchange cap pursuant to the Amendment. The three-judge panel bluntly expressed its discord with Judge Leon: "The district court granted summary judgment to the merchants concluding that the rules [interchange cap] violate the statute's plain language. We disagree."[146] After "[a]pplying traditional rules of statutory interpretation," the court held "that the Board's rules [interchange cap] generally rest on reasonable constructions of the statute."[147] By confirming that the Board did not exceed the authority that Congress granted to it, the appellate court ensured that the interchange cap would not be reconfigured.

While the holding of the appellate court elicited a sigh of relief from the banking industry, the Amendment is still, and will always be, too restrictive because of its "hopelessly confiscatory nature."[148] Astoundingly, this fact has eluded each round of litigation that has been triggered since the implementation of the Amendment, as courts instead focused

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141 *See* NACS v. Bd. of Governors of Fed. Reserve Sys., 958 F. Supp. 2d 85 (D.D.C. 2013).

142 Complaint at 7, *NACS*, 958 F. Supp. 2d 85 (No. 11-02075).

143 *NACS*, 958 F. Supp. 2d at 106.

144 *Id.*

145 Epstein, *supra* note 14.

146 NACS v. Bd. of Governors of Fed. Reserve Sys., 746 F.3d 474, 477 (D.C. Cir. 2014).

147 *Id.*

148 Richard A. Epstein, *The Improbable Fate of the Durbin Amendment*, POINTOFLAW.COM, (James R. Copland, ed., Mar. 28, 2014, 1:54 AM), http://www.pointoflaw.com/archives/2014/03/the-2010-enactment-of-the.php.

on tracing the contours of its regulatory scheme.[149] However, if the Amendment is subjected to the proper mode of analysis, or the confiscatory rate doctrine, the unconstitutionality of its price controls will be exposed.

B. The Confiscatory Rate Doctrine Applied

1. The Amendment Enforces an Unconstitutional Confiscatory Rate

By analogy, *Michigan Bell Telephone Co. v. Engler*[150] reveals the constitutional deficiencies of the Amendment. In that case, plaintiffs, who were providers of telephone service, contested the constitutionality of the Michigan Telecommunications Act, which aimed to control intrastate telephone rates.[151] The Act in question abolished one of several fees that plaintiffs charged their customers on a monthly basis and temporarily froze their telephone rates.[152] Plaintiffs argued that the provisions of the regulatory Act violated their constitutional right to a reasonable rate of return on their investment.[153] In its analysis, the district court held that the statute "*clearly* does not guarantee a constitutionally adequate rate of return for regulated telephone service providers because it merely permits telephone service providers to cover *costs*, and does not ensure a fair and reasonable rate of return on investment."[154] Simply, the regulatory Act was unconstitutional because it inefficaciously secured the plaintiffs' right to a fair profit by merely setting rates "at a level which only accounts for the *cost* of providing services."[155]

Like the Michigan Telecommunications Act, the Amendment limits the monetary amount that issuing banks can recoup for the service provided. As mentioned, the Amendment instructed the Board to devise a fee that is "reasonable and proportional to the cost" of a debit transaction.[156] In doing so, the Board was only to consider "the incremental cost incurred by an issuer for the role of the issuer in the authorization, clearance,

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[149] *See* NACS v. Bd. of Governors of Fed. Reserve Sys., 958 F. Supp. 2d 85 (D.D.C. 2013); *NACS*, 746 F.3d 474.

[150] Mich. Bell Tel. Co. v. Engler, 257 F.3d 587 (6th Cir. 2001).

[151] *Id.* at 591.

[152] *Id.*

[153] *Id.*

[154] *Id.* at 594 (citing *In re* Permian Basin Area Rate Cases, 390 U.S. 747 (1968)) (first emphasis added).

[155] *Mich. Bell Tel. Co.*, 257 F.3d at 595.

[156] 15 U.S.C. § 1693*o*-2(a)(2).

or settlement of a particular electronic debit transaction" and to exclude all "other costs incurred by an issuer which are not specific to a particular electronic debit transaction . . . ."[157] Essentially, the interchange fee cap only includes "the marginal costs of providing interchange, leaving fixed/sunk costs unrecoverable."[158] Under the Board's own evaluation, the Durbin Amendment will bar issuers from recovering the bulk of costs accompanying the debit card business:

> We also looked at whether we should have a more expansive definition of allowable costs that would go beyond authorization, clearing and settlement, and look at other costs that are specific to a transaction . . . . So things like the costs associated with rewards programs or . . . costs that [issuing banks] incur to handle card holder inquiries about particular transactions . . . . Those are costs that if they were to have been incurred in the check context, the bank would not be able to get reimbursement of those costs from the payee's bank, so because of that we did not put them into the bucket of costs that would be considered in determining what the maximum interchange fee initially would be allowed to have.[159]

Hence, issuers are not compensated for the costs incurred in relation to enrolling cardholders or promoting debit usage, customer service, billing, advertising, and promotional activities.[160] Additionally, the Amendment fails to cover the costs of each debit transaction, or the narrow costs it permits.[161] For example, although the Board set the interchange cap at $0.21 per transaction, costs associated with each swipe have been projected to be $0.27.[162] This discrepancy reveals that the boards interchange cap will cause issuing banks to lose money every time a card is swiped. Thus, like *Engler*, issuing banks are not only prevented from receiving a "constitutionally-required fair and reasonable rate of return,"[163] they are also prevented from recovering the costs associated with maintaining a debit card business.

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157 15 U.S.C. § 1693*o*-2(a)(4).

158 Hubbard, *supra* note 13, at 13.

159 Report of Kevin M. Murphy, *supra* note 97, at 21 n.70.

160 *Id.* at 21; Epstein, *supra* note 75, at 65.

161 Report of Kevin M. Murphy, *supra* note 97, at 21.

162 *2011 Debit Issuer Study: Amid Strong Market, Issuers Bracing For Pending Changes*, PULSATIONS: THE DEBIT NEWS MAG. 11 (May 2011), *available at* https://www.pulsenetwork.com/pulse/documents/index/serveDoc.html?doc=PULSATIONS-2011-05-06.

163 Mich. Bell Tel. Co. v. Engler, 257 F.3d 587, 595 (6th Cir. 2011).

2. Private Businesses are Entitled to Protection from Confiscatory Rates

Nonetheless, the *TCF* court and proponents of the Amendment have opined that the confiscatory rate doctrine is inapplicable, even if the Amendment's regulations compromise an issuing bank's business, because its protections are applied only within the context of public utility companies that possess monopolistic characteristics.[164] This is a dubious argument. Not only is there a proliferating inclination "to use the word 'utility' loosely in referring to many different kinds of regulation covering a wide range of businesses,"[165] 140 years of case law has demonstrated that "any firm legally compelled to sell at a controlled price, even a firm that cannot be classified as a utility, is entitled to the protection" of the confiscatory rate doctrine.[166]

For example, the confiscatory rate doctrine has been applied within the livestock auction market industry, although such operators are not public utilities that bear monopolistic qualities.[167] In both *Giles Lowery Stockyards v. Department of Agriculture* and *Central Arkansas Auction Sale Inc. v. Bergland*, plaintiff auctioneers complained that the rates set by the Department of Agriculture were confiscatory.[168] Particularly, plaintiffs criticized the ratemaking scheme, opining that it failed to account for their investment in the business because it exposed them to unreasonably low rates for their services, hindering their constitutional right to a reasonable rate of return.[169] In response, the court examined whether the aforementioned rates allowed for a fair profit in light of the fact that auction market plaintiffs were "small operations located in cattle producing areas," or "small" private businesses "with investments less than $50,000."[170]

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[164] TCF Nat'l Bank v. Bernanke, No. CIV 10-4149, 2011 WL 1578535, at *3-4 (D.S.D. Apr. 25, 2011); Lisa Farrell, *A Step in the Right Direction: Regulation of Debit Card Interchange Fees in the Durbin Amendment*, 15 LEWIS & CLARK L. REV. 1077, 1101 (2011) (citing Barr et al., *supra* note 131, at 431).

[165] Barr et al., *supra* note 131, at 438.

[166] Drobak, *supra* note 130, at 123 (1986); Epstein, *supra* note 14, at 29; Brief of Petitioner-Appellant, *supra* note 130, at 20, 27.

[167] *See* Central Ark. Auction Sales, Inc. v. Bergland, 570 F.2d 724 (8th Cir. 1978); Giles Lowery Stockyards, Inc. v. Dep't of Agriculture, 565 F.2d 321 (5th Cir. 1977); Brief of Petitioner-Appellant, *supra* note 130, at 28.

[168] *Central Ark. Auction Sales, Inc.*, 570 F.2d at 726; *Giles Lowery Stockyards, Inc.*, 565 F.2d at 323-24.

[169] *See Giles Lowery Stockyards*, 565 F.2d at 324.

[170] *See id.* at 324-25, n.5; *see also Central Ark. Auction Sales, Inc.*, 570 F.2d at 728.

Similarly, other non-monopolistic utilities in the insurance industry have enjoyed the protections of the confiscatory rate doctrine.[171] In both *Keystone Insurance Co. v. Foster* and *Aetna Casualty and Surety Company v. Commissioner of Insurance*, plaintiff automobile insurers attacked a declaration that introduced an auto insurance rate reduction in response to gradually increasing costs, arguing that the regulated rates amounted to a taking because they were confiscatory.[172] In considering plaintiff's rationale, the *Foster* court held that the "provision would . . . avoid a confiscatory impact on" the insurance company if it allowed "a regulated business to obtain a fair return on its property given the risks."[173] Even more strikingly, the *Aetna* court articulated that although the confiscatory rate doctrine "has been applied . . . to rates for public utilities, it is as applicable" to plaintiff insurers, although they were comprised of "seventy companies licensed to sell insurance," unlike a monopolistic setting, where a single seller dominates the market.[174]

When scrutinized in the aggregate, the aforementioned case law dictates an application of the confiscatory rate doctrine when a business is legally coerced into selling at a regulated price, regardless of whether it can be classified as a public utility with monopolistic characteristics. Hence, auction operators, various insurers,[175] cab companies,[176] and a surfeit of other industries have been shielded by the doctrine, as it intercepted attacks on their financial integrity through the form of confiscatory rates.[177] Similarly, the application of the confiscatory rate doctrine is appropriate within the context of the financial industry, as the holdings of the previous decisions pierce through the misguided averments of the Amendment's supporters, who claim that monopolistic utilities are granted a higher degree of security from takings.

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[171] *See* Keystone Ins. Co. v. Foster, 732 F. Supp. 36 (E.D. Pa. 1990); Aetna Cas. & Sur. Co. v. Comm'r of Ins., 263 N.E.2d 698 (Mass. 1970); Brief of Petitioner-Appellant, *supra* note 130, at 30.

[172] *Keystone Ins. Co.*, 732 F. Supp. at 37; *Aetna Cas. & Sur. Co.*, 263 N.E.2d at 699.

[173] *Keystone Ins. Co.*, 732 F. Supp. at 36, 38 (citing Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989)).

[174] *Aetna Cas. & Sur. Co.*, 263 N.E.2d at 699.

[175] *See* Med. Malpractice Joint Underwriting Ass'n of R.I. v. Paradis, 756 F. Supp. 669 (D.R.I. 1991).

[176] *See* Yellow Cab Co. v. City of Chicago, 919 F. Supp. 1133 (N.D. Ill. 1996).

[177] Brief of Petitioner-Appellant, *supra* note 130, at 32.

3. Issuing Banks Cannot Practically Withdraw From the Debit Business

Nonetheless, the *TCF* court and proponents of the Amendment misguidedly contend that the application of the confiscatory rate doctrine is unbecoming because issuing banks are not compelled to engage in the debit industry, and may avoid the regulation by abandoning this portion of their business.[178] While some courts have disregarded this point,[179] the previous argument highlights the significance of a business's capacity to renounce from a regulated business.[180] However, it fails to account for the consequential distinction between legal and practical barriers.[181] While a firm may not be under any "legal compulsion to remain in business" if "its investments are such that it cannot afford to withdraw from the price-controlled business without inordinate financial loss, it is a fiction to justify the lack of constitutional protection on the basis of the ability to withdraw."[182]

For example, in *Tenoco Oil Company, Inc., v. Department of Consumer Affairs*, gasoline refineries and wholesalers challenged the constitutionally of a regulatory statute which empowered the Secretary of the Puerto Rican Department of Consumer Affairs to set prices in the former's business.[183] The refiners and wholesalers filed complaints alleging that the Act violated the Takings Clause because it set rates at a confiscatory level.[184] The court conceded that the plaintiffs "may choose, over the duration of price controls, to abstain from selling gasoline and thus will not suffer any loses."[185] Distinguishing between theory and practice, the court discussed the economic realities of a business's choice post-regulation:

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[178] TCF Nat'l Bank v. Bernanke, No. CIV 10-4149, 2011 WL 1578535, at *3 (D.S.D. Apr. 25, 2011); Farrell, *supra* note 164, at 1103.

[179] Central Ark. Auction Sales, Inc. v. Bergland, 570 F.2d 724 (8th Cir. 1978) (holding that the confiscatory rate doctrine should be applied although plaintiffs were free to cease operating the regulated business); *Yellow Cab Co.*, 919 F. Supp. at 1140 n.4 (holding that the principles of the confiscatory rate doctrine were necessary although the defendant "argue[d] that there can be no [T]aking in this case because [plaintiff] can avoid the effect of the" regulatory statute because it is free to stop leasing cabs and could hire its own drivers instead); Aetna Cas. & Sur. Co., 263 N.E.2d 698 (holding that a statute regulating auto insurance was confiscatory even though the defendant's argued that "if the companies cannot write the insurance at [the challenged] rates they are free to stop writing it").

[180] Barr et al., *supra* note 131, at 440; Drobak, *supra* note 130, at 119.

[181] Barr et al., *supra* note 131, at 441-42; Drobak, *supra* note 130, at 120, 123-24.

[182] Drobak, *supra* note 130, at 123.

[183] *See* Tenoco Oil Co., Inc. v. Dep't of Consumer Affairs, 876 F.2d 1013 (1st Cir. 1989).

[184] *Id.* at 1017.

[185] *Id.* at 1027 n.21.

> This supposed freedom to temporarily leave the market may be largely illusory, however. Even if the wholesalers hoarded their present inventories to be sold when they could obtain a higher price, they still would have to meet their fixed costs—overhead, salaries, storage, etc. In practice, such a course might very well be economically prohibitive.[186]

The practical and economic barriers that prevented the plaintiffs from exiting the regulated business influenced the court's decision to apply the confiscatory rate doctrine to determine if the Act at issue confiscated plaintiff's property in violation of the Takings Clause.[187]

Although issuing banks, like the plaintiffs in *Tenoco Oil Company*, are not legally compelled to remain in business, their position is such that they cannot afford to depart from the regulated field without exposing themselves to inordinate financial loss. Issuing banks' mammoth sunk costs, represented by the "billions of dollars" invested "to help develop an efficient, convenient, and secure debit-card payments system," represents the de facto facet of compulsion.[188] This type of investment produces assets that are "typically immobile and suitable only to a single purpose—delivering the services the utility is obligated to provide."[189] Accordingly, issuing banks are in a vulnerable position because "[f]irms with investments in specialized assets are less able to withdraw from a price-controlled business."[190] Therefore, "a government can set lower prices for these firms with a greater likelihood that the firms will continue to sell their products at the regulated prices."[191] Hence, the absence of the confiscatory rate doctrine in this situation would present issuers with a Hobson's choice: exit the business and lose massive sunk costs or remain in the business in return for revenues that make the service exceptionally unprofitable.

4. Recouping Amendment-Induced Losses is Unfeasible

Alternatively, previous court decisions and Amendment proponents unpersuasively argue that the confiscatory rate doctrine is not pertinent to the Amendment because even if economic barriers exist, issuing banks may remain in the debit business and retrieve lost interchange revenue by (1) charging

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186 *Id.*
187 *Id.* at 1026.
188 Brief for the Clearing House Ass'n et al., *supra* note 131, at 1.
189 Barr et al., *supra* note 131, at 441.
190 Drobak, *supra* note 130, at 127.
191 *Id.*

their customers for the regulated line of service, or debit card usage and (2) placing fees for the use of unregulated lines of business, such as checking account or credit card fees.[192] The illustration in this note's introduction demonstrates the impracticability of the former argument, while the latter argument is precluded by Supreme Court case law.

First, an issuing bank's ability to recover lost interchange revenue from its regulated line of business is not constitutionally permissible, as illustrated by *Tenoco*. The limited scope of financial remedy is elucidated by the opinion's pragmatic examination of a regulated business's choice after a rate reduction: "[a] price regulation which forces wholesalers to sell [the service] for a price which does not cover operating costs and a reasonable profit may . . . become so onerous that the wholesalers will be unable to ever recover their earlier cumulative losses through *subsequent price increases* . . . ."[193] In such a situation, a business's attempt to assimilate into the regulated field by charging for services that were previously honorary will fail to "restore value to the investment the wholesaler made" within its specific industry because of inexorable economic realities, and "may . . . force[it] out of business."[194]

The court's abstract language transforms into a palpable argument when applied to the banking industry, as post-judgment events have proved that customer sensitivities will preclude issuing banks from charging customers for debit card usage. Previously, the Eighth Circuit admitted that it "is not clear" whether such pressures serve as a restriction, since issuing banks could *possibly* offset their losses by "charg[ing] their customers for the privilege of using their debit card services."[195] However, after a plethora of regulated banks announced that they planned on charging consumers for using their debit cards, the financial industry was engulfed by an avalanche of consumer condemnation that has prevented the debit-issuing community from offsetting their losses through usage fees.[196] The substantial drops in stock prices, explosive consumer outrage, rebellious consumer campaigns, and

[192] TCF Nat'l Bank v. Bernanke, 643 F.3d 1158, 1164 (8th Cir. 2011); Brief for the Clearing House Ass'n et al., *supra* note 131, at 23-26; Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81722, 81733 n.44 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

[193] Tenoco Oil Co., Inc. v. Dep't of Consumer Affairs, 876 F.2d 1013, 1027 (1st Cir. 1989) (emphasis added).

[194] *Id.*

[195] *TCF Nat'l Bank*, 643 F.3d at 1164.

[196] Bernard & Protess, *supra* note 19; Fitzpatrick & Sidel, *supra* note 24.

dissenting consumer petitions that ensued within 72 hours of the announcement illustrated the unfeasibility and destructiveness of a debit usage fee.[197] Since the financial industry's plan never came to fruition, debit owners have "contributed exactly zero to the bottom line,"[198] and the Eighth Circuit's assumption, that suggested that the "issuing banks could make up their lost revenue somehow by charging their own customers" for debit card use, has "proved false".[199]

However, even if the financial industry disregarded that unforgiving display of consumer backlash by implementing usage fees, a Time Moneyland survey exposes another weapon that debit users could employ: the ability to switch banks, which is what roughly 75% of those polled promised to do.[200] Agitated consumers have an abundance of tempting options, as the Amendment's small bank exemption allows 99 percent of banks to receive pre-Amendment interchange rates that, in turn, are used to keep debit card services free.[201] While consumers likely are not bluffing,[202] the situation is exacerbated by post-judgment "legislation that would make it easy for consumers to switch banks and simultaneously swap their direct deposit, electronic bill paying and other automatic features."[203] This looming threat is another reason why covered banks could never recoup lost interchange revenues through debit usage fees from their customers.

Second, an issuer's ability to recoup lost interchange revenue from an unregulated line of business is not constitutionally acceptable. In *Brooks-Scanlon Co. v. Railroad Commission of Louisiana*, a non-monopolist dealer of lumber was directed to operate a railroad in congruence with the Commission's proposed schedule.[204] Plaintiff supplier alleged that the order would force it to operate at a loss of $1,500 per month.[205] In turn, the Court inquired whether the lumber company should subsidize the railroad through its profitable and

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[197] Ylan Q. Mui, *supra* note 12; White, *supra* note 23; Fitzpatrick & Sidel, *supra* note 24.

[198] Epstein, *supra* note 18.

[199] Epstein, *supra* note 148.

[200] White, *supra* note 23.

[201] Hubbard, *supra* note 13, at 18-19.

[202] White, *supra* note 23 (explaining "that roughly two-thirds of people who say that they plan to switch banks do").

[203] Ryan Grim, *Bank of America Debit Card Fee Leads to Legislative Response*, HUFF POST (Nov. 11, 2011 5:12 AM), http://www.huffingtonpost.com/2011/09/30/bank-of-america-fee_n_992623.html.

[204] Brooks-Scanlon Co. v. R.R. Comm'n of La., 251 U.S. 396, 397 (1920).

[205] *Id.*

unregulated lumber business.[206] Justice Holmes, in a unanimous decision, opined that the plaintiff "cannot be compelled to carry on even a branch of business at a loss" though the plaintiff "may be making money from its sawmill and lumber business."[207] He continued, "It no more can be compelled to spend that than it can be compelled to spend any other money to maintain a railroad for the benefit of others . . . ."[208] Accordingly, the plaintiffs could not be obliged to operate at a loss even though an unregulated line of their business was profitable. Like the plaintiff supplier, the fact that issuing banks may be able to negate losses from below cost rates through other unregulated lines of business, such as checking or credit, is immaterial. As *Brooks-Scanlon* unequivocally holds, government-induced losses that are confiscatory do not become constitutional merely because they can be offset through other unregulated lines of business.

C. The Amendment's Absence of a Judicial Filter Mandates Legal Intervention

The futility of the various mitigation arguments, as well as the fact that issuing banks cannot request special relief from the Amendment, though it is a regulatory statute where "careful administrative procedures are customary," further illuminates the need of labeling the Amendment with a confiscatory mark. For example, in *Keystone*, the court hesitated to dub the amendment at issue with a confiscatory label because it contained a "'safety valve' . . . permitting rate relief" for companies experiencing "extraordinary circumstances."[209] The court's reluctance illustrates its desire to evade needless constitutional inquiries when the provision at issue permits the regulated party to avoid a confiscatory impact through a self-help mechanism.

However, this concern is inapplicable within the debit industry, as regulated issuing banks cannot avoid a confiscatory impact without judicial interference, unlike the plaintiffs in *Keystone*. Yet, proponents of the Amendment may argue that a constitutional safety valve is implicit within the text of the Amendment because it discriminates between large banks, or those who do not need protection, and small banks, or those that would. Notwithstanding the fact that the other two

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[206] *Id.* at 399.

[207] *Id.*

[208] *Id.*

[209] Keystone Ins. Co. v. Foster, 732 F. Supp. 36, 38 (E.D. Pa. 1990) (internal quotation marks omitted).

major regulations of the Amendment do apply to small banks, the irrationality of this argument is revealed through the arbitrariness of Congress's line drawing.[210] For example, "[t]he four largest banks each have assets greater than $1 trillion. . . . By drawing the 'large bank' line at $10 billion, banks with less than 1 percent of the assets of the four largest banks are subject to the same regulatory regime."[211] Though the Amendment does discriminate, the vast spread of its reach abrogates its spurious safety valve, further illustrating the necessity of judicial intervention.

CONCLUSION: REPEAL THE AMENDMENT AND RESTORE THE FREE MARKET SYSTEM

Proponents of the Amendment account for the above mentioned constitutional deficiencies and economic consequences by clinging onto Judge Leon's holding, and contending that the Board's interchange cap never accurately reflected "the language of the law or Congress's intent."[212] If it had, the Amendment's goals would have come to fruition, and its ensuing problems would have been avoided. However, this convenient explanation is misguided. Rather, the Amendment's perverse effect is the result of a thoughtless decision: "[w]ithout committee hearings by either chamber of Congress, [Senator Durbin] proposed . . . a price-capping arrangement for debit . . . card interchange fees that had never been proposed or discussed in the extensive academic literature on the subject."[213] The various interchange fee studies that resulted from Senator Durbin's statutory scheme undermined the Amendment's rationality and "the U.S. Department of Justice stated that it was opposed to regulation of interchange fees . . . ."[214] Accordingly, these *unintended* consequences that have emerged are not the product of a failed implementation of intent, but rather the result of an "out of the blue" and last-minute amendment that has radically controlled rates in areas that were never intended to be regulated,[215] without

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210 Hubbard, *supra* note 13, at 17-18.

211 *Id.* at 18 ("Bank of America has $2.3 trillion; Chase and Citi each have $2 trillion; and Wells Fargo has $1.2 trillion.").

212 Woodward & Daly, *supra* note 129; *Merchants' Lawsuit Says Fed Failed to Follow on Swipe Fee Reform*, REUTERS (Nov. 22, 2011 1:00 PM), http://www.reuters.com/article/2011/11/22/idUS192842+22-Nov-2011+BW20111122.

213 Epstein, *supra* note 14, at 24.

214 Evans, *supra* note 17, at 3.

215 *Id.* at 8.

any thoughtful examination of how debit markets function.[216] Even Senator Durbin, who initiated the Amendment's implementation, missed an opportunity to blame the regulation's perils on the Board, as he "declined through a spokesman to comment on the consequences of the law."[217]

However, the Amendment's perils will not disappear through the identification of a scapegoat; rather, the inefficiencies that have been created by "government intervention in the free market" will subdue when Congress's bipartisan voices are heard, and the Amendment is repealed.[218] In fact, Barney Frank, the Amendment's coauthor, believes "'that a free market approach in [the debit card market] will be better for the economy and all concerned parties than the current system.'"[219] Yet if the opinions of these bipartisan and third party leaders are not persuasive, perhaps Australia's decade-long experience with interchange fee regulation is. After reflecting on Australia's interchange regulatory record, the Government Accountability Office stated "[i]f the fee limit option were chosen, a challenge for implementation would be setting and maintaining interchange fees at a level [that] effectively balanced the costs among networks, issuers, merchants, and consumers . . . ."[220] In other words, the intricacies of debit's economic platform significantly decrease the chances of the government's arduous task of setting a more efficient interchange fee than the private market would produce.[221] Hence, the annulment of the Amendment would not only "restore balance"[222] to the electronic market, but also retract the egregious consequences that have plagued small-ticket merchants and consumers, all while restoring the efficiency of the financial system.

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[216] Epstein, *supra* note 14, at 24.

[217] Robin Sidel, *Debit-Fee Cap Has Nasty Side Effect*, WALL ST. J. (Dec. 8 2011), http://online.wsj.com/news/articles/SB10001424052970204319004577084613307585768.

[218] REPS. CHAFFETZ AND OWENS TO INTRODUCE LEGISLATION TO REPEAL DURBIN AMENDMENT, CHAFFETZ (Oct. 12, 2011), *available at* http://chaffetz.house.gov/press-release/reps-chaffetz-and-owens-introduce-legislation-repeal-durbin-amendment.

[219] Timothy H. Lee, *When Even Barney Frank Sings the Praises of Free Markets, We Must Listen*, FORBES (May 28 2013), http://www.forbes.com/sites/realspin/2013/05/28/when-even-barney-frank-sings-the-praises-of-free-markets-we-must-listen/

[220] Hubbard, *supra* note 13, at 45.

[221] *Id.*

[222] CHAFFETZ, *supra* note 218.

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