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ABSTRACT

The passage of the Durbin Amendment in July, 2010 followed extensive claims by Senator Durbin and retailers that the only consequence of the law would be to bleed out the excessive debit interchange charges that platform operators and issuing banks collected from retailers. In their view, the proper source of revenues was from debit card holders themselves, as in the Canadian system. Events have not played out that way. After the Federal Reserve authorized a \$0.21 base interchange fee, which was generous given the narrow statutory language, the major banks found it impossible to raise rates in the face of sustained political and market pressure, goaded on in part by Senator Durbin himself. At the same time, there is no evidence that the reduction in debit card fees have been passed through by merchants to their customers.

The reason this adventure into regulation has failed is that Senator Durbin and his allies did not understand the operation of the fast-moving two-sided debit card market. In their view, platform operators like Visa and MasterCard operated a duopoly that afforded them the market power to extract rents from merchants while feeding oversized fees to issuing banks in order to attract new streams of customers. That analysis ignores two brute facts. First, the only contest between platform operators, banks and merchants is over the considerable surplus generated by a debit card interchange system. Those fees are constrained because merchants always have the option to pull out of the system if interchange rates are set too high. Second, the interchange fees paid to the issuing banks are not just kept in a vault, but are spent in maintaining the fixed costs of running the system and recruiting new customers, so that all rents are dissipated by these competitive forces. There is, therefore, no unearned surplus, and issuing banks are now forced to adopt inefficient systems of fee collection to offset the nearly \$8 billion in lost interchange fees.

Full awareness of the competitive nature of the debit interchange market should have led the courts to declare the current regulatory system a confiscatory form of ratemaking. The combination of higher administrative fees under the Durbin Amendment and lower returns necessarily pushes banks below a competitive rate of return on key debit card services, especially since subsequent events have made clear that there will be zero recoupment in revenues from charges to debit card holders. The level of confiscation is still greater because smaller banks—those with under \$10 billion in assets—may continue to collect their full interchange fees in ways that tilt the market even further. Nonetheless, by adopting an all-too-forgiving rational basis test, the courts sustained the statute by showing excessive deference to Congress.

Given the situation today, tinkering will not fix the inherent structural defects of the Durbin Amendment, which should be repealed forthwith before it does any greater damage to debit card transactions.

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I. INTRODUCTION: THE COMING OF AGE OF THE DURBIN AMENDMENT

News coverage on debit cards has increased exponentially since Senator Richard Durbin proposed his amendment to the Dodd-Frank financial reform legislation in March 2010. The Amendment gained a lot of initial traction in the Congress, and, with no Congressional hearings in either house, was signed into law on July 21, 2010.¹ The key feature of the Durbin Amendment is that it sets a hard cap on the level of interchange fees that may be charged by big banks (defined by statute as those whose assets exceed \$10 billion).

These fees are not set by the Amendment itself, which only contains an explicit instruction limiting these fees to the “incremental costs” associated with the “authorization, clearance, or settlement” of a discrete debit card transaction.² The actual numerical rules for calculating these fees were set under the Amendment by the Federal Reserve Board, by capping the amounts charged to about \$0.21 cents per transaction with small allowances for additional payments to cover the costs of fraud prevention and fraud loss.³ That basic \$0.21 figure was challenged in an unsuccessful lawsuit brought by TCF Bank. Once the challenge was decisively rejected by the Eighth Circuit,⁴ the program went into effect on October 1, 2011.

During the litigation, the claim was commonly made that the regulated banks could offset any revenue loss from the Durbin price caps by raising the direct fees that they charged to their own customers for debit card use. That offsetting fee could take place either on a monthly basis or on a per transaction (or per-swipe) basis. Bank of America,⁵ Wells Fargo,⁶ and several other banks sought to make good on that option by setting debit card fees at between \$3 and \$5 per month.⁷

But the huge level of popular resistance by debit card customers, spurred on by Senator Durbin,⁸ the media,⁹ and various activist groups, turned this recoupment effort into a nonstarter.¹⁰

Consumers who have long gotten debit cards for free are in no mood to pay a dime.¹¹ All the proposed fees were eliminated, leaving big banks to scramble for other ways to either reduce costs or increase revenues to control the near-\$8 billion gap that the imposition of the Durbin Amendment left on bank balance sheets.¹²

The banks were already in perilous condition because of the general downturn in the market, the glut of real estate in foreclosure, and the various restrictions that the CARD Act¹³ had imposed on credit card fees in 2009.

At the same time, the Durbin Amendment has caused dislocations for small merchants.¹⁴ Prior to the passage of the Amendment, debit interchange fees were commonly a percentage of the particular transaction, such that banks made up any losses on small transactions by the higher fees on the larger ones. That system meant that merchants were willing to keep all transactions in the system because the debit card fees did not eat up the profits. But once the Durbin Amendment capped maximum fees, the banks raised the fees on smaller transactions to the level of the cap to make up for those lost fees on larger transactions, which in turn chipped away at profit margins for retailers whose business consisted of large numbers of small transactions.

Moreover, a recent study by the Electronic Payments Association finds that merchants have not passed through debit interchange savings to consumers. One does not have to accept that extreme conclusion, for competition may result in some degree of price reduction on the merchant side.¹⁵ To be sure, representatives of retailers have consistently claimed that they would pass their savings through to customers.¹⁶ As a matter of basic political economy, however, it is highly unlikely that those pass-throughs would be dollar-for-dollar: why would merchants push so hard for the Durbin Amendment if they could not keep a large chunk of the gains for themselves?

In the end, therefore, the new situation is likely to prove unstable, so that the entire system could partially unravel as some merchants opt out of the system, which in turn means that there are fewer transactions to cover its fixed costs. As is always the case, price controls have unintended, and unwelcome, consequences.

In this article, I review the various economic and legal issues that arose from the time that Senator Durbin first proposed his Amendment in May of 2009 until the present.¹⁷

Until the Durbin Amendment, the good news for debit cards was that it had sparked an expanding market with relatively little legislation or administrative action—a sign that it was in good health. Left to its own devices, that well-functioning market demonstrated its continued ability to process billions of transactions in an apparently effortless fashion.

It did so because all market participants had strong incentives to extract virtually all potential gains through their repeated transactions.

Everyone stayed with the system because everyone profited from it; each player had at least some piece of the overall gains.

The activities that meet this mutual gain condition are, in turn, capable of generating sufficient profits to insure the continued quiet expansion of the market sparked by strong innovation and powerful consumer acceptance.

Once public cries of discontent gain traction they usually translate into ill-considered regulation that, caught in the vise of the rule of unintended consequences, only makes operations on the ground worse.

At present, the final stage of that cycle is now being played out in the debit card market. To show the trajectory of debit card regulation, I proceed as follows: in Section I, I recount the institutional arrangements that have made the debit card system a continued success story; Section II recanvasses the arguments that were invoked successfully to justify the major form of regulation contained in the Durbin Amendment; I examine the legal arguments that surround the unsuccessful, but sound, constitutional challenge that was raised against the Durbin Amendment in Section III. I conclude with a broad look at the consequences of the Amendment on banking institutions and the broader economy.

II. THE DEBIT CARD IN GOOD TIMES

For many years, the most notable feature of debit cards was their ability to gain an ever-larger fraction of payment transactions. In 2009, debit cards became the most common form of payment, whether measured by dollars or by number of transactions.¹⁸ Debit cards outpaced their more expensive credit card rivals; they lapped the track with clunky paper checks and made major inroads into cash purchases. During the years 2005 to 2009, the volume of transactions increased, yet the average interchange fell. Thus in 2005, average debit interchange fees were about 1.83 percent on a purchase volume of \$2.651 billion. By 2009, the rate had dropped to 1.69 percent on a volume of \$3.663 trillion purchase, which translates into a 7.7 percent drop in rates on a volume increase of about 39 percent.¹⁹

Success on that order of magnitude did not occur by chance. All the relevant players in the payments market enter into hundreds of billions of transactions each year. If a system's overall design contains a serious glitch, players will discover it and thereafter will alter their behavior to mitigate their losses. Yet by the same token, when the new payment system produces systematic net benefits, the same parties will gravitate toward its use, even if they do not understand its precise mechanics.

This path of development marked the rise of the debit card. The debit-card universe involves, in its simplest iteration, five discrete players. At one end of the transaction lies the bank customer (doubling as a retail consumer) who receives a debit card from an (issuing) bank. The bank earns its revenues not by any direct charges against that customer, but by collecting an interchange fee from the retailer or merchant at whose establishment the customer uses that debit card to complete a transaction. The merchant requests through its own (merchant) bank verification that the customer is in fact able to pay the charge. This information is forwarded via a network platform—typically, but not always, Visa or MasterCard—back to the customer's bank, which can then authorize or decline the payment. Because that bank has up-to-date information about the status of the customer's bank balance, it can use complex algorithms to decide whether to authorize or decline payment. When the transaction is approved, the issuing bank keeps part of the proceeds (typically around 1.35 percent of the transaction amount)²⁰ to cover

its own costs, and forwards the rest of the money to the network platform. The network platform then takes its (smaller) slice for routing the transaction to the merchant bank, who takes its own slice for servicing its business client. When these three slices are removed from the sales price, the merchant receives about 98 percent of the face amount of the transaction.²¹

A two-percent take from gross sales is a considerable expense in a low margin business.

But owing to the repeat nature of these transactions, retail merchants, faced with fierce competition, continue to pay this fee for one and only one reason: they receive in return benefits in excess of the costs imposed.

Defenders of the Durbin Amendment say that merchants only pay their fees because they need to keep up with the competition. They write: *"Because the RLC's [Retail Litigation Center] members must accept debit cards to remain competitive, they have had no choice but to pay these fees."*²² But that is precisely the point. Merchants compete by supplying the same low-cost services as their competitors. Keeping up with competition is good, not bad. Indeed, if it were bad, these keen competitors would opt out by reverting back to credit cards (which carry a higher interchange fee because of the greater credit risk assumed by the bank) or checks and cash, each of which have their own problems as payment mediums. Thus the system endures because it generates benefits to all players, including those who have groused about it most. At this point, it is possible to identify just what those benefits are.²³

1) Speed. The rapid pace of debit card transactions on check-out lines reduces the collateral costs of servicing these accounts. Check-out clerks can process more transactions per hour, and fewer customers walk away because they do not wish to stand in long lines for small purchases. Furthermore, in those settings where debit card transactions don't make sense, retailers can set up cash-only lines so its operations move smoothly, or they can just decline to accept the cards. These multiple options lead to advantages in the hands of a skilled professional.

2) Ticket uplift. Debit card use typically increases the size of a particular purchase because the customer is no longer constrained by the amount of cash in his or her wallet. A virtuous circle is at work in these situations: the knowledge that merchants accept debit cards offers yet another reason for consumers to carry less cash, thereby reducing the personal risk of theft or loss.

3) Information. The debit card gives all parties an accurate and instantaneous record of each individual transaction that can be used for multiple purposes. To the merchant, the collection of this information assists with better inventory control, cash management, and marketing. For customers, the transaction record allows them to know how much money remains in their deposit accounts. For banks, it allows better recordkeeping of their customers' balances. Good information in these cases is a clear advantage across the board.

4) Guaranteed payments. The debit card improves risk management by allowing the issuing bank to make up-to-date credit checks that reduce the risk of default. In this regard, it is critical to correct the common misconception that debit card holders must have sufficient funds in their accounts for their bank to authorize the transaction. It does wonders for customer relations to allow clients to overdraw their accounts toward the end of each pay period, and to recoup those lost revenues when the next pay check comes in a day or two later. Since the banks have the superior information, they can take the credit risk away from the merchants by guaranteeing payment on authorized transactions (only), whether or not the customer defaults. That risk of loss can also be shifted with the use of debit cards. But that arrangement will work only if issuing banks in the long run can cover two costs: those of running the system, and those of covering the losses that still occur from assuming these risks. At this point, however, the existence of these debit-card losses is not a sign of social dislocation, for the banks have every incentive to make the right trade-offs at the margin, by refusing to extend credit when the risk of loss appears too great. This risk-shifting operation is far more costly when payments are made by check, since the issuing bank has no better information about the proposed transaction than the party who accepts the check.

In the abstract, this bundle of benefits may not be sufficient to justify the interchange fees that banks exact for debit cards. But there is no need to speculate as to the relative benefits and tradeoffs, given the system's growth.

At this point the correct inquiry is: when a system produces net benefits to all participants, is it nonetheless possible to identify some market imperfection that justifies regulation?

Once that imperfection is identified, the next question is whether it is possible to develop a regulatory scheme that corrects that imperfection at an acceptable cost. Under this inquiry, it is not enough to show some deviation from the standards of perfect competition. It is necessary to show that the deviation is large enough to justify the particular regulatory response that is imposed.

III. RATE REGULATION FOR DEBIT CARDS: IMPERFECT INFORMATION AND MONOPOLY POWER

In the context of debit cards, there are only two plausible justifications for rate regulation of debit cards. The first is to find some information asymmetry. The second is to find some exercise of monopoly power. Both justifications are addressed below.

A) IMPERFECT INFORMATION

The Durbin system of rate regulation cannot be justified as a means to counter supposed informational deficits in the debit card market, especially on the part of merchants who are so intimately familiar with its operation. Likewise, the customers who continually revert to debit card use learn debit card operations, if not as a matter of abstract logic, then through experience. Customers prize debit cards for the want of direct fees, for their convenience, and for the various extra bonuses that banks dispense to lure customers to sign up. It has been suggested that consumers should be told of the debit card fees that are hidden in the total purchase price,²⁴ yet retailers are not required to disclose all the

other cost components of their business, such as electricity, rent, salaries and merchandise. The information that consumers use to make decisions concerns the price and quality of goods that are under consideration for purchase.²⁵

They buy if the price is less than the net benefit, and decline to purchase if it is not. Information about component costs is just a distraction, for few consumers will switch from the lower to higher cost identical good merely because the cheaper good embeds a higher cost of electricity. Moreover, whatever disclosures might be required under this logic deal not with the debit fee itself but with the bank charges for administration and bad debt losses. Yet neither of these charges bears any relation to the severe price caps now authorized under the Durbin Amendment.

B) MONOPOLY PROFITS

The question of potential monopoly profits requires more analysis than that devoted to information asymmetry. The proponents of the Durbin Amendment, including the Senator himself, have long insisted that the credit card companies, most especially Visa and MasterCard, exert market power over the industry in virtue of their "duopoly" controlling the two major platforms for debit card transactions. Senator Durbin insisted that the Amendment "will prevent the giant credit card companies from using anti-competitive practices."²⁶

On this account, this precarious situation did not come about through competition or through a healthy market for debit cards. To the contrary, debit card networks such as Visa and MasterCard, and the banks that issue their debit cards, have imposed this system on merchants through collusion, with banks agreeing not to compete over these fees, and through the market power that the banks exercise through the networks. Because retailers must accept debit cards to remain competitive, they had no choice but to pay these fees.²⁷

The clear implication of this position is that collectively, the banks and the debit card networks are able to extract some additional revenue by virtue of their control over the key middle step in the debit card system. The claim of "collusion" is not wholly correct, for it were, all parties to the collusive arrangement would have organized a system of horizontal price restrictions

that would be in violation of Section 1 of the Sherman Act. There have been cases involving tie-in arrangements that have raised these antitrust concerns,²⁸ but

there is no case in which anyone has attempted to show collusion between rivals at either the network or the bank level.

The claim that such collusion exists therefore has to rest on the claim that both Visa and MasterCard has chosen to raise their rates, knowing that the other is likely to follow suit. That form of “parallel pricing” is difficult to prove (or disprove), since there is no independent evidence of what the pure competitive rate would otherwise be.²⁹

The level of gains that can be reached through any form of tacit collusion are always smaller than those that can be achieved by direct linkage between the parties; under a Cournot duopoly, each party ignores the gains that the other receives from raising prices, so that in equilibrium, the prices set are somewhere between the monopoly and competitive price. That possible gap shrinks still further for two other reasons. First, Visa and MasterCard do not have 100 percent of the market, but 83 percent,³⁰ which means that additional competitive forces are at work. Second, the market in payments generally is highly dynamic so that the prospect of further entry through new forms of payment, e.g. mobile phones, will induce the incumbents to lower their prices still further, at least in the long run, and perhaps sooner. Hence, even if there were some supracompetitive profits in this industry, they are likely to be small relative to the overall gain. In addition, *the alleged ability of Visa and MasterCard to extract these supposed rents is still limited by the key constraint that the rates charged to merchants must be low enough to keep them in the system.*

The estimated size of these rents matters, because the smaller their size relative to the gains generated by the system, the weaker the target for constructive interference, given that all forms of regulation are prey to two systematic risks: error costs in administration,

and flaws in design, induced by the price restrictions imposed through the political process.

These concerns with regulation are very much in play in the context of the strict rate caps imposed by the Durbin Amendment. The first, and most obvious, point is that the Durbin Amendment does not impose any restrictions at all on the rates that the debit card companies can charge for their services. That figure is small, in the neighborhood of 0.20 percent of the transaction, and far smaller than the fee charged by the issuing bank (around 1.35 percent) or the merchant bank (around 0.5 percent). It would be difficult for the merchants to claim that their own banks are involved in any collusion, so the only target that they have is the issuing banks, who also earn the bulk of the fee in question. The issue then arises, however, about market power, of which not even the largest bank—Bank of America—has.

What is needed is some theory that can explain why debit card companies are prepared to use their supposed monopoly clout in order to benefit the issuing banks with whom they have only an arm’s-length contractual position.

During the litigation, the retailers relied on a report by Steven C. Salop,³¹ written on behalf of the Merchants Payment Center, which purported to explain that connection. Under Salop’s view, the optimal system is the Canadian system, which uses no interchange fees at all, but has each side pay its own costs for running the system. As Salop explains, “The most economically reasonable way to satisfy the mandate for debit interchange fees that are reasonable and not disproportional to issuers’ costs is to adopt a presumptive standard of at-par interchange (“API”). Under this standard, there would be a strong regulatory presumption that interchange should be at-par for all debit card networks.”³² In effect, consistent with the logic of the Durbin Amendment, the model that is used for checks is carried over here.

The initial question to ask is whether there is any need for regulation at all, given the successful growth and evolution of the debit card system. One way to insure “minimal market intrusion,”³³ as Salop wishes, is not to regulate at all and let evolution take its course.

Cutting interchange rates by 100 percent (as the API model suggests), or reducing them to the incremental costs of authorization, clearance and settlement costs specified in the Durbin Amendment (Salop's fall-back position), are far cries from minimal market intrusions.³⁴ "Minimal" takes on a different coloration if there is a market failure. In this instance, however, Salop finds a sufficient source of market power, because "Visa and MasterCard have the ability to exercise significant market power over merchants with respect to the acceptance of debit cards by raising their interchange fees, which then are passed on to retailers by the acquiring banks."³⁵ The first half of the sentence is subject, of course, to the limitation that they cannot raise these fees to a level that drives merchants to other debit card providers or other forms of payment. Salop implicitly acknowledges the point when he observes that merchants accept the charges because "losing the sale would be costlier to the merchant than accepting debit and paying the high interchange fee."³⁶ Salop's remark is another way of saying that the debit interchange fee makes sense for merchants, such that the only remaining issue is to determine the division of gains from operating the system.

The Durbin Amendment therefore hits the wrong target by attacking issuing banks for market power which is said to lie with platform operators.

The question is why these operators would gratuitously divide monopoly rents, if any, with a group of competitive banks.

Salop's explanation for the transfer is that banks are in a stronger position vis-à-vis the platform operator than the merchants. Every merchant has to accept all debit cards, but each bank needs only one platform operator to run its business. The banks therefore can play the card companies off against each other in order to increase receive higher interchange fees.

This analysis is incomplete because it never asks what banks do with the added interchange revenues. They cannot just pocket the funds, for they are in aggressive competition with each other, forcing them to spend money to recruit and retain customers. Those activities work to the benefit of merchants and platform owners. By lowering price and raising service, interbank competition brings additional debit card users into the system.

At no point does Salop explain why competition for customers does not drive bank returns down to competitive levels. His report offers no evidence of any extraordinary returns for the banking industry. Nor does it ask the vital question of whether the use of interchange fees supplies an efficiency advantage that cannot be duplicated by forcing issuing banks to cover all their debit card cost through fees collected solely from their own customers, in order to let debit card transactions clear at par.

To see what is missing, it is necessary to discuss more deeply the operation of these two-sided markets.³⁷ In his expert testimony, Salop refers repeatedly to these markets,³⁸ but does so solely to show their monopoly tendencies: "In two-sided markets, networks with market power may be able to exercise substantial market power over one side of the market but be able to exercise less (if any) market power over the other side of the market."³⁹ But at no point does he address the classic efficiency explanations for the rise of voluntary two-sided markets, which date back to the classic paper by William Baxter in 1983,⁴⁰ and which were elaborated in the expert testimony prepared for TCF National Bank by Kevin Murphy.⁴¹

The ability of the platform operator to coordinate cross payments from one side of the market to the other opens up a potential gain from trade that cannot be captured in the at-par system that Salop champions. The simplest version of the story is that these payments take advantage of the different levels of elasticity on the two sides of the market. The merchants, whose demand for debit payments is highly inelastic, pay something to customers, whose demand is highly elastic, and who thus are more willing to leave the system. These merchant payments are not made directly, but through the interchange system to the issuer, in order to help them bring in customers to the system who might otherwise stay out.

Those payments are not specific to any merchant, and hence when spent by the issuing banks, they improve the entire operation of the system. The individual merchants therefore need not worry about free-riding by rivals because they know that the standardized interchange fees reduce the ability of any given merchant to foist its costs off on other parties. The greater number of customers who are brought into the system further increases the willingness of consumers and merchants alike to remain in the system.

The fixed rate schedule for interchange fees, when set by the platform operators in competition with each other, eliminates the expensive costs of negotiating individual transactions and thus improves the overall efficiency of the system.

This increased efficiency undermines the view that fixed fees are only of use in setting cartel-like prices for issuing banks that are in heavy competition with each other.

The American debit card system has proved more innovative than its Canadian rival because it allows for both foreign and online transactions (at the time of the litigation, these two types of transactions could not be performed over the Canadian system,⁴² which also featured very high first-party interchange fees running between \$0.50 and \$0.60 per transaction in 2004).⁴³

Since all consumers are involved on both sides of the deal—that is, with both the merchant and the issuing bank—their preference is for a set of arrangements that minimizes the sum of their costs on both sides of the transaction.

In this environment, the broad scale acceptance of the system suggests that it has done that. No one can argue that a network industry achieves a perfect competitive solution, for that result is impossible no matter what interconnection rules are adopted. But it should remind us how difficult it is to construct a regulatory framework that works better than these voluntary deals.

In this institutional environment, the Durbin Amendment constitutes a classic case of regulatory overkill.

The rate restrictions that are set exceed those necessary to combat any risk of market power by Visa or MasterCard, and they bear no relationship to the tiny monopoly rents, if any, that issuing banks can extract from the system. Indeed, the Durbin Amendment makes no effort to calibrate its price caps to offset any supposed level of market power.

Instead, it treats the entire debit interchange system as if it were some kind of public utility that is allowed to recover its costs, but not a risk-adjusted competitive rate of return. The rate base for the regulation is tied to the notion of incremental cost, which does not allow for any recovery of the extensive fixed costs incurred to operate the system.

In addition to the transaction-specific costs of authorizing, clearing and settling a transaction, a bank must design, construct, maintain and upgrade the basic system, supply support services for existing customers, and invest in soliciting new customers, which is no mean task given the high rate of debit card turnover. TCF, for example, “has been required to open 500,000 to 600,000 accounts each year just to maintain its customer base,”⁴⁴ all at, in the pre-Durbin days, no cost to the customer. The Durbin scheme therefore contemplates that all these costs should now be switched from the interchange system to the customers in ways that approach the Canadian system. For that to happen, all these additional costs should be recouped directly from customers, which has turned out to be institutionally impossible once the Durbin Amendment has gone into effect. The question is how these various elements line up in connection with the legal challenges to the Durbin Amendment that were turned aside in the Eighth Circuit.

IV. CONSTITUTIONAL CHALLENGES TO THE DURBIN AMENDMENT

A) PROSPECTIVE AND RETROSPECTIVE REGULATION

The basic challenge to the Durbin Amendment rests on the view that the rate regulation imposed under this system has to be tested by the same constitutional rules that apply to other forms of rate regulation.⁴⁵ In this instance, there are two approaches to the question, one of which deals with prospective regulation generally, and the other which deals with the greater protection that is afforded for public utilities that have made specific investments in plant and equipment.

The difference between these prospective and retroactive forms of regulation is reflected in the standard of constitutional review that is applied. For prospective regulation, the current standard supplies a low level of protection under the “rational basis” test, and the challenger faces a steep uphill climb.

This was in fact the test adopted in the TCF case, where the Eighth Circuit opined:

"Parties making substantive due-process claims concerning economic regulations generally face a highly deferential rational basis test, whereby the burden is on the one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way. Similarly, the standard for determining whether a state price-control regulation is constitutional under the Due Process Clause is well established: Price control is unconstitutional if arbitrary, discriminatory, or demonstrably irrelevant to the policy the legislature is free to adopt."⁴⁶

Perhaps the most famous rate-making case of this sort is *Nebbia v. New York*, where the Supreme Court upheld **minimum** prices for milk in a competitive industry against a charge that they violated the economic liberties of the milk producers, who wanted to sell milk at below the regulated prices.⁴⁷

Similar arguments have been used to uphold rent control statutes, which set maximum rentals, against charges of confiscation, at least if the rentals allowed were sufficient to cover the cost of providing services to the tenant even if they did not allow the landlord to any rent increases to reflect the appreciation of the underlying asset.⁴⁸ Indeed the most influential formulation of the rules that are associated with regulatory takings are those found in *Penn Central Transportation Co. v. City of New York*,⁴⁹ under which the local government was allowed to prevent the use of air rights for new construction of a landmarked building on the ground that the revenues received from the operation of the existing facility were sufficient to cover its costs. Finally, in *Yakus v. United States*, the Supreme Court sustained a general system of prospective price controls put forward for all goods and services under loose guidelines that left a fair level of administrative discretion in the joints.⁵⁰

Faced with these precedents, it may be easy to conclude that virtually any system of rate control passes constitutional muster. But the issues are far more subtle than this initial analysis suggests. *Yakus*, in particular, was decided only two months after the Supreme Court handed down its public utility rate regulation case in *Hope Natural Gas v. Federal Power Commission*,⁵¹ which took a very different approach toward public utility regulation with respect to invested capital that had already been committed to a particular venture.

B) TRADITIONAL PUBLIC UTILITY RATE REGULATION

At issue in *Hope* was the form of rate protection for public utilities that must incur huge sunk costs **before** they can begin the operations that allow them to recoup their initial investment and operating costs. In these situations, two warring concerns require reconciliation.⁵² The first is that, traditionally, the public utility has a natural monopoly in the geographical region in which it operates. The high fixed costs of building a plant are such that no second company can enter the market at a cost below that which the incumbent can charge for its services, even if allowed to do so as a matter of law.

The key assumption that supports this view is that over the relevant range of output, the incumbent has declining marginal costs that allow it to price additional units of service below those which the new entrant must charge in order to cover the heavy costs to set up his initial system. Put otherwise, the industry operates at a lower cost with one firm than it does with two. The level of monopoly power is only entrenched further if the public utility commission is vested with the power to deny a license to any new entrant that might decide to brave entry. Rate regulation is one permissible means to combat the use of this monopoly power.⁵³

The problem is that the system of rate regulation cannot operate in a fashion that makes it impossible for the utility to recover its sunk costs over the useful life of its capital investments. Thus, in a world devoid of constitutional protection, the public utility commission could trap the utility once it has gone into operation by setting rates that allow it to recover revenues beyond its marginal costs, but that do not allow it to recover the fixed costs plus a suitable rate of return over the useful life of the regulated facility. So long as these rates are above marginal cost, the utility loses more money if it withdraws from the market than if it remains.⁵⁴ As a result, unless there is protection against that misbehavior once the utility is in operation, no one will set up a plant in the first place, given the ever-present risk of confiscation.

The utility therefore needs ironclad guarantees that it will be able to recover not only its fixed costs, but also a reasonable profit that is needed to attract and retain capital.

The system of rate regulation under Hope Natural Gas must make some provision that the rate structure will allow for that return.

The question then arises how the courts supervise this constitutional standard given the difficulty of its administration. Courts have adopted a two-part approach. The first is setting the ideal standard, on which the command is categorical. The legislature cannot drive the regulated firm below that risk-adjusted rate of return, where the adjustments in question take into account that a natural monopoly in a stable geographical market faces lower risks than the ordinary competitive return. The regulator is then given wide discretion on the way in which various items of revenue and expense are taken into account, on the ground that intermediate errors along the way should not attract judicial attention, so long as the “bottom line” meets the appropriate standard.⁵⁵

The key point is that this process under Hope Natural Gas applies to any firm that has made fixed investments in its own facilities.

The state could avoid any and all obligations of this sort if it announced in advance that it will only allow a firm to enter this market if it accepts the risk of confiscation, at which point the firm can protect its position by declining the opportunity. Thus under current law, if (before the onset of the debit card business) Congress passed a statute that forbade all debit interchange fees, the regulation would stick, and the business as it emerged might well follow along Canadian lines. In this environment, however, regulators are unlikely to impose these restrictions, because they understand the brutal truth that these prohibitions could easily discourage or block the needed investment in the first place. No regulator therefore imposes confiscatory rates that operate in futuro only.

At this point, it must be stressed that all banks made their initial investments in debit cards in an unregulated, competitive market, in which their ability to work out in advance the details of the debit interchange system through long-term contracts protected them against merchant expropriation. Since these investments were all made in depreciable assets that are typically not sold, there is no possibility that they will appreciate over time in the manner of residential real estate.

Hence it is perfectly sensible to set the rate of return in ways that allow for the recovery of the initial costs over the useful life of the assets. Rate regulation of industrial facilities does not pose the serious danger of abuse present in rent control, where the appreciation of rental property is in effect transferred to the tenant through the statutory right to remain on the premises long after the expiration of the original lease. Instructively, however, the rent control rules also provide that the rates cannot be set so low as to deny recovery on the original investment, which is all that is claimed in this case. ations are addressed below.

C) DEBIT CARD REGISTRATION

Once rate regulation is imposed on banks that have invested capital in their debit card systems, the same consideration applies: the revenues that the firm receives over the useful life of that equipment must be sufficient to allow for the recovery of all relevant costs. These costs are, as in the public utility cases, much more extensive than the incremental costs associated with the supply of individual units of service, and each variation on the public utility rules requires the rate base to include those elements.⁵⁶ The same situation is required here, for otherwise the government is allowed to engage in a bait and switch, whereby it encourages investment under one legal regime, only thereafter to deny the firm its needed recovery once the investment is made under a second. The only question is how the analysis plays out as the discussion moves from traditional public utilities to debit card transactions.

In dealing with that issue *there are two major differences between the debit interchange market and standard public utility regulation*, there are two major differences between the debit interchange market and standard public utility regulation, one of which strengthens the TCF challenge to the Durbin Amendment and the other which cuts against it. The first difference is that rate regulation here is imposed on what is a virtual competitive industry, where any pocket of monopoly power is tiny relative to the systematic long-term territorial monopoly of the standard public utility. That is, the analysis above makes it clear that there are no supracompetitive profits for government regulation to

bleed out of the system. As a matter of simple math, if the current rate of return in this industry is **already** at the risk-adjusted competitive rate, any government effort to reduce that rate of return and to add administrative costs into the system **necessarily** pushes the regulated issuing bank below the competitive rate of return. The monopoly cushion that is available to regulated industries that have monopoly power, either because of their economic position or because of some legal privilege, is **never** available for a firm that is already at the competitive position that is the end point for any sound system of rate regulation.

The reduction of revenues under the Durbin Amendment thus leads to a confiscatory rate structure for all invested capital unless the revenues lost through regulation can be recovered from the other side of the market.

In dealing with this issue, the Eighth Circuit found that the opportunity to recoup lost revenues from customers, in the manner of the Canadian system, was the Achilles' heel to TCF's case. The Eighth Circuit wrote:

The Durbin Amendment only restricts how much certain financial institutions issuing a debit card may charge for processing a transaction; it does not restrict how much those institutions may charge their customers for the privilege of using their debit-card services. Since TCF is free under the Durbin Amendment to assess fees on its customers to offset any losses under the Durbin Amendment, it is unlikely that the Durbin Amendment has created a sufficient price control on TCF's debit-card business so as to trigger a confiscatory-rate analysis, or that the law could, in fact, produce a confiscatory rate. Indeed, the heart of any confiscatory-rate claim is the ability to show that the government has set a maximum price for a good or service and that the rate is below the cost of production (factoring in a reasonable rate of return), which TCF has simply not shown on this record.⁵⁷

In making this argument, the Eighth Circuit is conscious of the procedural posture of the case, under which TCF must meet a heavy burden of proof in order to enjoin the statute before it is put into effect.⁵⁸ That claim in turns stands or falls on the question of how best to value that right. In these circumstances the analysis can occur in three separate ways.

The first involves the analytics of the matter, without taking into account the statutory exemption for banks with less than \$10 billion in assets. The second takes that exemption into account. The third considers the political fallout from the Durbin Amendment.

Under the first scenario, there is clearly no direct information about the various strategies that banks will use to recoup their losses. For the purposes of this analysis, it must be assumed that once the banks are faced with the rate regulation under the Durbin Amendment, they will take all steps within their power to mitigate the losses imposed on them. We can assume for the sake of analysis that they will engage in error-free strategy, so that they will cut back on benefits and increase their fees in ways that maximize their profit position, conditional on the passage of the Durbin Amendment.

These changes do not matter, so long as the attack is directed to the investment that the regulated banks have made in the system.

Given the operation of two-sided markets, it follows that any system that bans interchange fees forces banks to get all their income from the consumer side of the market.

The chances that even the best alternative strategy can put the banks back to their pre-Durbin state of earnings (recall that this is the competitive rate of return, which eliminates any margin of error) by making that 100 percent recoupment are zero. Two sources of revenue are always greater than one, especially when the theory of two-sided markets holds unambiguously that payments across the platform generate additional efficiencies that the Canadian at-par system cannot hope to match. If the Canadian system were as efficient, the banks would have no reason to object to the Durbin Amendment, and indeed no reason to set up the debit interchange system in the first place. The only disputed question therefore is the extent of the loss, not its existence. If litigation involved efforts to determine the amount of money that the government owed for imposing these restraints, the question could not be resolved before the systems were put into effect. But given that the government has made it clear that no compensation is in the cards, the size of the shortfall is utterly immaterial to the outcome of the case.

There is no state of the world where the compensation derived from customers could, even conceivably, provide the perfect offset needed to restore the competitive rate of return.

It might be said that this point ignores the possibility of market power, which I criticized above. Ironically, that objection was disposed of on appeal by the District Court's finding that the debit card industry was in fact competitive among the issuing banks.⁵⁹ As Justice Piersol noted, "there is no monopoly power assumed to be associated with issuing debit cards. Plaintiff is not a public utility under rate case jurisprudence. The case law relied upon by Plaintiff is therefore inapplicable to its due process claim."⁶⁰ His point gets it exactly backwards. As the case law has long recognized, firms in competitive markets are entitled to the opportunity to run their business at a profit.⁶¹ The want of market power strips the government of any reason to regulate debit card rates in the first place. Accordingly, the level of scrutiny to rate regulation should be **higher** when the government seeks to regulate the rates of a competitive firm.⁶² The mathematics show that the government should lose under any and all circumstances. Thus in a competitive market, the relationship between revenues and costs sets up the risk-adjusted rate of return as follows:

$$\frac{R - C}{R} = \pi$$

In this simple equation, R equals revenues, C equals costs, and π equals profit under competitive conditions. In the new environment R^* ($= 0.5R$) is less than R, and C^* ($= 1.5C$) is greater than C, such that π^* is necessarily less than π . To see why, take the case of a regulation that cuts revenues in half—as under the Durbin Amendment—and increases compliance costs by the same amount. To this point,

$$\frac{R^* - C^*}{R^*} = \frac{0.5R - 1.5C}{0.5R} = \frac{2(0.5R - 3C)}{R} = \frac{R - 3C}{R} = \pi^* < \pi$$

The results do not depend on the choice of coefficients for R and C after regulation. So long as the revenues are less than one, and the costs are greater than one, the coefficient for C will be greater than one while those for R will be one, so that the inequality holds in all states of

the world. The case against Durbin on the assumption that markets are competitive rises to the level of a truth.

The second state of the world is the current one, where the banks whose assets are below \$10 billion are exempt from the restrictions on interchange fees. At this point, the case against the Durbin Amendment is stronger than it was before, because the differential form of regulation necessarily reduces the pricing and marketing strategies available to the big banks. The only question that is worth asking is how significant the cost differential would turn out to be. In work done for TCF Bank, Anne Layne-Farrar estimated that there would be high slippage rates if the banks sought to recoup the estimated \$10 in lost interchange fees through direct monthly charges.⁶³ In dealing with this issue, the Eighth Circuit held that these concerns did not matter because it looked at the rate differential only in connection with an asserted equal protection claim, and not as part of the larger rate-making position. Under that view, it was easy to note that there was an understanding that Durbin was "protecting smaller banks, which do not enjoy the competitive advantage of their larger counterparts and which provide valuable diversity in the financial industry."⁶⁴

The Eighth Circuit did not explain how the smaller banks managed to compete and retain market share prior to the passage of the Durbin Amendment, or why their presence in the market did not already contribute to some needed diversity in the financial industry.

By partitioning the small banking exemption from the taking claim, it ignored the close connection between them. Confiscation in the guise of protection of small (but certainly not infant) industry is a convenient intellectual crutch that avoids all serious analysis.

At this point, however, there is no longer any need for speculation, so that the heavy burden of proof that is needed for a preliminary injunction is not in place. Everyone who worked on the TCF litigation was of the view that some recoupment of debit card fees was at least possible after the imposition of the Amendment. Today, we know better. There were efforts by Bank of America and Wells Fargo to impose fees, but the onslaught of negative publicity and thinly veiled threats by Senator Durbin⁶⁵ led to their withdrawal.

V. CONCLUSION

The history of the Durbin Amendment offers powerful evidence for the sources of economic decay in the United States. In the Senate, a strong populist appeal by Senator Durbin drives forward a system of rate regulation that never received any scrutiny before it was added into the Durbin Amendment. The economic analysis that supported his position rested on untenable claims of market power that overlooked the efficiency dynamics of interchange fees, even in a competitive market.

The stubborn unwillingness of courts to look critically at how these markets operate leads them to ignore the inexorable reasons why the Durbin Amendment, under existing constitutional standards, should have been Dead On Arrival.

The stubborn unwillingness of courts to look critically at how these markets operate leads them to ignore the inexorable reasons why the Durbin Amendment, under existing constitutional standards, should have been Dead On Arrival. The litigation is over for the moment, but the bad consequences remain. The disruption of the mechanics of the debit card system show a nation committed to a converging point of view where large sums are invested in regulation that will reduce the operating efficiency of the market. Banks are at this point under siege in virtually all their operations. The scope of modern regulation seems to have a new message, which is to help secure the failure of big banks that are exposed to serious risks of failure.

- 1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010) (to be codified in scattered sections of the U.S. Code).
 - 2 More precisely, the Durbin Amendment commands that interchange fees be “reasonable and proportional to the cost incurred by the issuer with respect to the transaction.” The terms “reasonable” and “proportional” cannot be read in isolation, but must be understood in light of their own statutory definition, which requires Federal Reserve in issuing regulation to 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 . . .
- Dodd-Frank Act, sec. 1075, § 920(a)(4)(B)(i)–(ii), 124 Stat. at 2068–69 (to be codified at 15 U.S.C.A. § 1693o-2(a)(4)(B)).
- In addition, the Durbin Amendment instructs the Federal Reserve to “consider the functional similarity” to “checking transactions that are required within the Federal Reserve bank system to clear at par.” Dodd-Frank Act, sec. 1075, § 920(a)(4)(A)(ii), 124 Stat. 1376, 2068 (2010) (to be codified at 15 U.S.C.A. § 1693o-2(a)(4)(A) (West 2010)).
- 3 12 C.F.R. pt. 235, available at <http://www.gpo.gov/fdsys/pkg/FR-2011-07-20/pdf/2011-16861.pdf>.
 - 4 *TCF Nat’l Bank v. Bernanke* (TCF I), No. CIV 10-4149, 2011 U.S. Dist. LEXIS 45059, at *14 (D.S.D. Apr. 25, 2011), *aff’d*, 643 F.3d 1158 (8th Cir. June 29, 2011).
 - 5 Linette Lopez, *After Dropping Debit Card Fees, Bank of America Is Quietly Cranking Them Up Elsewhere*, BUSINESS INSIDER, Nov. 14, 2011, http://articles.businessinsider.com/2011-11-14/wall_street/30396471_1_debit-card-swipe-fees-overdraft-fees-costs-banks. The introduction of new, and more inefficient fees, is what one should expect.
 - 6 Vivek Shankar, *Wells Fargo Cancels Pilot of Monthly Fee for Debit Cards*, BLOOMBERG, Oct. 29, 2011, <http://www.businessweek.com/news/2011-10-28/wells-fargo-cancels-pilot-of-3-monthly-fee-for-debit-cards.html>.
 - 7 Robin Sidel, *Big Banks Blink on New Card Fees*, WALL ST. J., Oct. 28, 2011, available at <http://online.wsj.com/article/SB10001424052970204505304577002041853240850.html>.
 - 8 See Letter from Senator Richard Durbin, to John Stumpf, CEO of Wells Fargo (Oct. 29, 2011), available at http://durbin.senate.gov/public/index.cfm/statementscommentary?ContentRecord_id=b4fe225f-fc62-455f-abbb-6f9f4c1c60d5:

But you did not earn these fees by bettering your competitors in a free market, which is how Main Street businesses have to make their money. Rather, you made this lucrative revenue stream because the Visa and MasterCard duopoly fixed the same high swipe fee rates for your bank that they did for every other bank—thus immunizing this revenue stream from competitive pressure and enabling fees to keep going up even as processing costs went down. It is disingenuous for banks to claim they are somehow entitled to make up reductions to a revenue stream that they never would have received in the first place in a transparent and competitive market.
- For a discussion of these claims, see *infra* at Section III, B (page 18).

- 9 See Ann Carrns, *Fees Help Drive Working Poor From Banks*, N.Y. TIMES, Oct. 21, 2011, available at <http://bucks.blogs.nytimes.com/2011/10/21/fees-drive-working-poor-from-banking-system> (explaining the fees without stopping to ask how banks were able to secure debit cards under the supposedly defective system that the Durbin Amendment had just dismantled).
- 10 For my account, see Richard A. Epstein, *The Debit Card Stealth Tax*, *Defining Ideas*, Oct. 4, 2011, <http://www.hoover.org/publications/defining-ideas/article/95011>.
- 11 *Four in Five Consumers Won't Tolerate a Monthly Debit Card Fee*, PYMNTS.com, Dec. 7, 2011, <http://pymnts.com/regulations/debit-checking/four-in-five-consumers-won-t-tolerate-a-monthly-debit-card-fee>.
- 12 “The limits, mandated by the Dodd-Frank Act, may cut annual revenue by \$8 billion at the biggest U.S. banks, according to data compiled by Bloomberg Government.” Hugh Son, *Debit-Fee ‘Flop’ Leaves Banks Seeking \$8 Billion in Revenue*, BLOOMBERG, Nov. 2, 2011, <http://mobile.bloomberg.com/news/2011-11-02/debit-fee-flop-leaves-u-s-banks-looking-for-8-billion-in-lost-revenue>.
- 13 The Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. 111-24, 123 Stat. 1734-1766 (2010).
- 14 Eamon Murphy, *How Durbin’s Debit Card Fee Cut Backfired on Small Merchants*, DAILY FINANCE, Dec. 8, 2011, <http://www.dailyfinance.com/2011/12/08/how-durbins-debit-card-fee-cut-backfired-on-small-merchants>.
- 15 **“There is no evidence that American consumers are benefitting from the Durbin amendment, despite overwhelming evidence that the retail industry is experiencing significant savings.”** (bold in original), Electronic Payments Coalition, *Where’s the Debit Discount: Durbin Price Controls Fail to Ring Up Savings for Consumers 3*, Electronic Payments Coalition, Dec. 12, 2011, <http://wheresmydebitdiscount.com/wp-content/themes/epc/media/Where’s%20My%20Debit%20Discount%20-%20Durbin%20Price%20Controls%20Fail%20to%20Ring%20Up%20Savings%20for%20Consumers.pdf>, [hereinafter EPC, *Debit Discount*].
- 16 See, e.g., Statement of Mallory Duncan Senior Vice President and General Counsel for the National Retail Federation: “Merchants are ready to pass lower swipe fees along to consumers in the form of discounts and other benefits as soon as reform goes into effect.” Press Release, National Retail Federation Press Release, Legislation Introduced to Delay Swipe Fee Reform up to Two Years (Mar. 15, 2011), available at http://www.nrf.com/modules.php?name=Newsletter&op=viewlive&sp_id=323&id=51.
- 17 For a more extensive treatment of many of these issues, see Richard A. Epstein, *The Constitutional Paradox of the Durbin Amendment: How Monopolies are Offered Constitutional Protection Denied to Competitive Firms*, 63 FLA. L. REV. 1307 (2011), [hereinafter Epstein, *Durbin Paradox*]; see also Richard A. Epstein, *The Dangerous Experiment of the Durbin Amendment*, 34 REGULATION 24 (Spring 2011) [hereinafter Epstein, *Durbin Experiment*].
- 18 The Wall Street Journal reported the cycle as follows: as late as 1995, debit card use was minuscule; by 2000, debit transactions were still only a small fraction of credit card transactions; yet, by the end of 2008, Visa debit card volume had overtaken credit card volume by number of transactions, but not by value. In the next year, 2009, total outstanding credit card debt dropped by over \$100 billion, from \$957 billion to \$866 billion, but debit usage continued to grow. Simultaneously, consumers cut back sharply on the use of checks. Total check volume fell five percent per year each year from 2000 to 2006. By 2005, aggregate debit card transaction value exceeded the sum of aggregate cash and check transaction value for retailers.
- 19 EPC, *Debit Discount*, *supra* note 14, at 4 n. 6.
- 20 For data, see Amended Complaint, *TCF Nat’l Bank v. Bernanke* (TCF I), No. CIV 10-4149, 2011 U.S. Dist. LEXIS 45059, at *14 (D.S.D. Apr. 25, 2011), *aff’d*, 643 F.3d 1158 (8th Cir. June 29, 2011); ANNE LAYNE-FARRAR, LECCG, *ASSESSING RETAILERS’ COSTS AND BENEFITS FROM ACCEPTING DEBIT CARDS 3* (2011).
- 21 Brief for Retail Litigation Center, Inc. as Amicus Curiae Supporting Appellees at 1, *TCF Nat’l Bank v. Bernanke*, 643 F.3d 1158 (8th Cir. June 29, 2011) (No. 11-1805) [hereinafter RLC Brief].
- 22 For a more exhaustive statement, see LAYNE-FARRAR, *supra* note 20, at 11-14.
- 23 See LAYNE-FARRAR, *supra* note 20, at 3.

- 24 See *supra* note 19.
- 25 The only cases in which these inputs matter, and often greatly, are in connection with campaigns that address child labor or trafficking in endangered species. Such campaigns present issues far removed from those involved with debit cards.
- 26 Press Release, Durbin Statement on His Debit Card Swipe Fee Amendment (May 13, 2010), available at <http://durbin.senate.gov/public/index.cfm/pressreleases?ID=506e66c9-13bd-455c-ba21-d749148b5d5e>.
- 27 RLC brief, *supra* note 21, at 4.
- 28 *In re Visa Check/Mastermoney Antitrust Litig.*, 297 F. Supp. 2d 503, 506–07, (E.D.N.Y. 2003), *aff'd* sub nom. *Wal-Mart Stores, Inc. v. Visa U.S.A., Inc.*, 396 F.3d 96 (2d Cir. 2005), *cert. denied* sub nom. *Leonardo's Pizza by the Slice, Inc. v. Wal-Mart Stores, Inc.*, 544 U.S. 1044 (2005).
- 29 Although it is clear that these cases do not allow for antitrust liability, it does not follow that some administrative remedy beyond antitrust law is necessarily out of order.
- 30 RLC brief, *supra* note 21, at 10.
- 31 STEVEN C. SALOP ET AL., MERCHS. PAYMENTS COAL., ECONOMIC ANALYSIS OF DEBIT CARD REGULATION UNDER SECTION 920 10 (2010), available at http://www.federalreserve.gov/newsevents/files/merchants_payment_coalition_meeting_20101102.pdf.
- 32 *Id.* at 3.
- 33 *Id.* at 6.
- 34 *Id.* at 3, 17, 24 and 38-42.
- 35 *Id.* at 3, 17, 24 and 38-42.
- 36 *Id.* at 14.
- 37 For my longer account, see Richard A. Epstein, *The Dangerous Experiment of the Durbin Amendment*, REG.: CATO REV. BUS. & GOV'T, Spring 2011.
- 38 *Id.* at 1, 13 and 29.
- 39 *Id.* at 1.
- 40 William F. Baxter, *Bank Interchange of Transactional Paper: Legal and Economic Perspectives*, 26 J.L. & ECON. 541 (1983).
- 41 For an extensive account, see Declaration of Kevin M. Murphy at 2, *TCF Nat'l Bank v. Bernanke*, 643 F.3d 1158 (8th Cir. June 29, 2011) (concluding emphatically, "[P]roponents of debit regulation have not identified any market failure that justifies intervention, because there are none"). For further discussion, see Epstein, *Durbin Paradox*, *supra* note 17, at 17-18.
- 42 Visa in fact pushes these two advantages in advertising its Visa Debit Card, which "lets you shop in more places online and around the world." What is Visa Debit?, <http://www.visa.ca/en/personal/visa-debit-card/index.jsp> (last visited Dec. 8, 2011).
- 43 JOHN BULMER, PAYMENT SYSTEMS: THE DEBIT CARD MARKET IN CANADA (2009), available at <http://www.parl.gc.ca/Content/LOP/researchpublications/prb0909-e.htm>. "In 2004, the typical transaction fee paid by debit cardholders to card issuers in Canada ranged from \$0.50 to \$0.60 per transaction; however, a number of cardholders paid neither a transaction nor a monthly fee for debit transactions."

The Canadian system, moreover, is run exclusively through an operation known as the Interac Association, which was created by its member banks, and which has its own antitrust issues. The American fees through the debit interchange system are, if anything, slightly lower. See *TCF Nat'l Bank v. Bernanke* (TCF I), No. CIV 10-4149, 2011 U.S. Dist. LEXIS 45059, at *10 (D.S.D. Apr. 25, 2011) (quoting Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,725 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235)); Epstein, *Durbin's Paradox*, *supra* note 17, at 1315 (reviewing how fees on a \$100 debit transaction are allocated).

- 44 Amended Complaint at ¶ 30, *TCF Nat'l Bank v. Bernanke* (TCF I), No. CIV 10-4149, 2011 U.S. Dist. LEXIS 45059, at *14 (D.S.D. Apr. 25, 2011), *aff'd*, 643 F.3d 1158 (8th Cir. June 29, 2011).
- 45 For more detail, see Epstein, *Durbin's Paradox*, *supra* note 17.
- 46 *TCF Nat'l Bank v. Bernanke* (TCF II), 643 F.3d 1158, 1163 (8th Cir. June 29, 2011).
- 47 *Nebbia v. New York*, 291 U.S. 502 (1933).
- 48 *Block v. Hirsh*, 256 U.S. 135, 153–54 (1921).
- 49 *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104 (1978).
- 50 *Yakus v. United States*, 321 U.S. 414, 422–23 (1944).
- 51 *Hope Natural Gas v. Federal Power Commission*, 320 U.S. 591 (1944).
- 52 For a useful summary of the difficulties, see *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1988). For discussion, see Michael W. McConnell, *Public Utilities' Private Rights: Paying for Failed Nuclear Power Projects*, 12(2) REGULATION 35 (1988), available at <http://www.cato.org/pubs/regulation/regv12n2/reg12n2-mcconnell.html>.
- 53 RICHARD A. POSNER, NATURAL MONOPOLY AND ITS REGULATION (1999).
- 54 There are additional complications if the utility is not permitted to withdraw from the market at all, at which point the rates could be set so low that it can only escape bankruptcy. At this point the risk of confiscation is even greater. But it is wrong to claim, as the government did in TCF, that there is no risk from government regulation unless the government explicitly blocks the exit right. For further discussion, see Epstein, *Durbin Paradox*, *supra* note 17, at 1339–41.
- 55 See *Hope Natural Gas*, 320 U.S. at 600–602.
- 56 For further discussion, see *Duquesne Light Co v. Barasch*, 488 U.S. 299 (1988).
- 57 *TCF Nat'l Bank v. Bernanke* (TCF II), 643 F.3d 1158, 1164 (8th Cir. June 29, 2011).
- 58 *Id.* at 1162.
- 59 *TCF II*, 643 F.3d at 1164.
- 60 *TCF Nat'l Bank v. Bernanke* (TCF I), No. CIV 10-4149, 2011 U.S. Dist. LEXIS 45059, at *12–13 (D.S.D. Apr. 25, 2011) (citing *Minn. Ass'n of Health Care Facilities v. Minn. Dep't of Pub. Welfare*, 742 F.2d 442 (8th Cir. 1984)). A similar point was made on appeal, *TCF II*, 643 F.3d at 1164, note 2.
- 61 While it is not constitutionally required to fix rates that will guarantee a profit to all insurers, it may not constitutionally fix rates that are so low that if the insurers engage in business they may do so only at a loss. See *Aetna Casualty & Surety Co. v. Commissioner of Insurance*, 263 N.E.2d 698, 703 (Mass. 1970).
- 62 Epstein, *Durbin Paradox*, *supra* note 17, at 1345–47.
- 63 ANNE LAYNE-FARRAR, *supra* note 20, at ¶ 13. Her key finding is:
I conclude that TCF's DDA [debit deposit accounts] customers are highly price sensitive. The statistical analysis suggests that should TCF impose a monthly fee of roughly \$8.33 on its DDA customers that use a debit card, it would likely see its rate of account closings rise by 58% to 81%.
- 64 *TCF II*, 643 F.3d at 1165.
- 65 Dan Fitzpatrick and Robin Sidel, *BofA Retreats on Debit Fee, Citing Uproar*, WALL ST. J., Nov. 1, 2011, available at <http://online.wsj.com/article/SB10001424052970204528204577011813902843218.html>.