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March 23, 2011

Louise L. Roseman
Director
Division of Reserve Payment
Operations and Payment Systems
Board of Governors of the
Federal Reserve System

Re: Docket R-1404

Dear Ms. Roseman:

The attached memorandum supplements American Express' February 22, 2011 Comments submitted in response to the Notice of Proposed Rulemaking "Debit Card Interchange Fees and Routing", Docket No. R-1404.

Please feel free to contact me if there are any questions.

Very truly yours,

Anne Segal

Anne L. Segal
Managing Counsel

memorandum

RE Authority of the Federal Reserve Board To Provide Exceptions or Differences in Treatment for Three-Party Networks under the Network Exclusivity Provision -- Docket R-1404

There are two bases on which the Board possesses legal authority to grant three-party, closed loop networks an exception from the network exclusivity and routing provisions:

(1) First and foremost, agencies have inherent authority to treat regulated entities differently when such treatment is justified by the facts in the administrative record and permitted under the language of the statute. The courts are required to defer to an agency's interpretation of ambiguous statutory language to provide for differences in treatment when that decision is justified by the record and avoids undermining the purposes of the statute.

An interpretation of the ambiguous language of the network exclusivity clause to provide different treatment for three-party and four-party networks is lawful and appropriate here, particularly because the three-party networks constitute a small part of the regulated industry, and three-party networks have nothing to do with the problem Congress sought to address in adopting the exclusivity provisions. Senator Durbin, the chief architect of these provisions, has expressly stated that "three-party systems . . . were not the intended focus of the non-exclusivity and routing provisions."[1] Accordingly, the Board has legal authority to interpret Section 920(b) as excluding three-party networks from the network exclusivity provision. Any other construction would produce results contrary to what Congress intended.

(2) Second, under Section 904(c) of the Electronic Fund Transfer Act, 15 U.S.C. § 1693b(c) ("the EFTA"), the Board has authority to issue rules that may make such classifications, differentiations or exceptions as are necessary or proper to effectuate the purposes of the EFTA. Even if the power to implement Section 904(c) transfers to the Consumer Financial Protection Bureau ("CFPB") on July 21, 2011, the Board will have authority to invoke Section 904(c) on April 21, 2011, the date on which it is required to issue the Final Rule. In any case, because of its inherent authority to treat regulated entities differently, the Board does not require the additional authority provided by Section 904(c) to conclude that three-party, closed loop networks should be excepted from the network exclusivity provision upon reaching the policy conclusion that recognition of such an exception is necessary or proper to carry out the purposes of the statute.

[1] Letter dated February 22, 2011 from Senator Richard J. Durbin to Jennifer J. Johnson at 16. (See http://www.federalreserve.gov/SECRS/2011/March/20110303/R-1404/R-1404_022211_67820_571445654740_1.pdf).

1. The Language of Section 920(b) Is Ambiguous and Permits The Board To Adopt a Rule that Grants Three-Party Networks an Exception from Application of the Network Exclusivity Provision.

The Board has plenary authority to implement the network exclusivity and routing provisions of Section 920(b), and its exercise of that authority would not interfere with the power of any other agency. Section 1084(3) of the Dodd-Frank Act adds a new Section 904(a)(2)(B) to the EFTA, which provides that: "The Board shall have sole authority to prescribe rules . . . to carry out the purposes of section 920." (Emphasis added) The network exclusivity and routing provisions are found in Section 920(b) and thus are subject to the sole authority of the Board.

The language of the network exclusivity provision is ambiguous and therefore enables the Board to exercise discretion to interpret and apply its terms.[2] The courts will defer to a reasonable construction of the statute by the Board that treats one group of regulated entities differently from others, where, as here, that interpretation is justified by the facts in the administrative record and will carry out the purposes of the statute, and when a contrary interpretation would defeat the intent of Congress underlying the statute. *See, e.g., Zuni Pub. School Dist. No. 89 v. Dep't of Education*, 550 U.S. 81 (2007).

The network exclusivity provision, Section 920(b)(1)(A), provides that the Board "shall ....prescribe regulations providing that an issuer or payment card network shall not directly or through any agent . . . restrict the number of payment card networks on which an electronic debit transaction may be processed . . . ." (Emphasis added) The term "restrict" is not a term of art with a specific meaning in the payment card industry. Rather, it is a common verb that is subject to a broad variety of possible meanings. The language of this statutory provision thus is "ambiguous" within the meaning of *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984).

"Statutory '[a]mbiguity is a creature not [just] of definitional possibilities but [also] of statutory context.'" *Zuni*, 550 U.S. at 98 (internal citation omitted). The statutory context in which the term "restrict" appears further demonstrates that three-party networks do not "restrict" the routing of electronic debit transactions for processing in the sense of that term that prompted Congress to adopt the network exclusivity provision. The text and the legislative history demonstrate that this provision was intended to put an end to a practice that had eliminated existing competition within the dominant four-party networks – namely, the practice by which the networks agreed with issuers that routing of all transactions conducted with debit cards issued by those banks would be restricted to an entity affiliated with that network. (*See* American Express Comments pages 4-5, 11-13).

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[2] This authority applies only to implementation of the network exclusivity and routing provisions in Section 920(b)(1). It does not apply to the interchange fee provision, Section 920(a). Section 920(a) authorizes the Board to regulate the "interchange transaction fee," a term that is unambiguous and has a specific meaning in the payment card industry as a fee that is unique to four-party networks.

The Board has substantial discretion to interpret the term "restrict" to clarify the ambiguities created by Congress. Such an interpretation will be upheld by the courts so long as it is reasonable. *Zuni*, 550 U.S. at 90. In determining whether an interpretation is reasonable, a reviewing court does not ask whether the agency made the best choice, or even the choice that the court might have made had the question been a matter of first impression, but rather whether the agency "'made a reasonable selection from among the available alternatives.'" *Iowa Utils. Bd. v. FCC*, 219 F.3d 744, 749 (8th Cir. 2000), *rev'd in part on other grounds, Verizon Communications, Inc. v. FCC*, 535 U.S. 467 (2002) (internal citation omitted). As the Board discussed in the Proposed Rule (75 Fed. Reg. 81,722, 81,748-49 (Dec. 28, 2010)), the "restrictions" with which the statute is concerned are exclusivity agreements between open loop networks and issuers that artificially limit debit transaction routing options. These restrictions are wholly inapplicable to the inherent business model as well as the operation of a three-party, closed loop network.

In sum, under the circumstances, it would be a lawful and reasonable construction of the phrase "restrict the number of payment card networks on which an electronic debit transaction may be processed" in Section 920(b)(1) as not applying to three-party networks. An integral part of the three-party, closed loop business model is to compete with the dominant four-party networks, and the three-party network does so by handling all authorization and routing of transactions with cards from its own network. Granting three-party networks such an exclusion would be fully consistent with the purposes of the routing requirements, by promoting competition and preserving the ability of three-party, closed loop networks to compete with the open-loop systems. The administrative record and Senator Durbin's comments fully recognize and provide compelling support for this approach.[3] Given the breadth and ambiguity of the statutory language, the courts would be required to defer to the Board's interpretation. *See Zuni*, 550 U.S. at 89-100 (Court upheld agency's interpretation of a statute that avoided a result that would undermine the reason for the statute's enactment, even though a more literal reading of the ambiguous language of the statute would have limited the agency's discretion); *Pension Benefit Guaranty Corp. v. LTV Corp.*, 496 U.S. 633, 648 (1990) (Court upheld agency interpretation when the statute did not evince "any clear congressional desire to avoid" the policy choice that the agency made, and where the agency's interpretation was "based upon a permissible construction of the statute" and avoided frustrating one of the objectives of the law.)

Finally, under the Administrative Procedure Act, the authority to change its interpretation falls within the powers granted to an administrative agency by the original delegation from Congress. The Supreme Court has held repeatedly that if an agency subsequently determines that a statute would be better implemented through a change in its rule, it may modify that regulation in a manner consistent with the statute in a subsequent rulemaking, subject to the requirement that it supply a reasoned explanation for its action. *See e.g., Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 42 (1983) ("an agency changing its course

[3] The dominant four party networks, on the other hand, argue that three-party networks should be compelled to open their closed loops to third-party routing. Given the legislative intent, the administrative record, and the public policy interest in supporting competition, this interpretation of the statute should be rejected.

by rescinding a rule is obligated to supply a reasoned analysis for the change," but does not bear any greater burden than it does in initially adopting a rule).[4] Accordingly, should the Board determine at some point in the future that a rule exempting three-party, closed loop networks from the network exclusivity and routing provisions should be modified or reconsidered, it could implement such a change to the Final Rule through a targeted rulemaking that could be accelerated or expedited as the Board deems appropriate under the circumstances.

2. The Board Possesses Authority To Provide an Exception to the Network Exclusivity Provision under Section 904(c) of the EFTA.

Section 904(c) provides that implementing rules promulgated by the Board under the EFTA "may contain such classifications [or] differentiations . . . and may provide for such adjustments and exceptions . . . as in the judgment of the Board are necessary or proper to effectuate the purposes" of the statute. 15 U.S.C. § 1693b(c). Even if the power to implement Section 904(c) were to transfer to the CFPB, the Board will possess the authority to implement that provision on April 21, 2011, the date when the Board is required to issue the Final Rule implementing Section 920(b).[5]

Exercise of the Board's inherent authority to provide reasonable interpretations of ambiguous statutory language, to provide exceptions where warranted by the administrative record, and to fulfill the purposes of the statute would preserve its continuing long-term ability to implement Section 920(b) to serve the public interest, even after authority to implement Section 904(c) has transferred to the CFPB. Nothing in Section 904(c) purports to limit the Board's authority to modify an exception after it has been granted.

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[4] As the Court stated in *FCC v. Fox Television Stations, Inc.*, 129 S. Ct. 1800, 1811 (2009):

> [The Administrative Procedure Act] makes no distinction, however, between initial agency action and subsequent agency action undoing or revising that action. . . . [t]he requirement that an agency provide reasoned explanation for its action would ordinarily demand that it display awareness that it *is* changing position. . . . And of course the agency must show that there are good reasons for the new policy. But it need not demonstrate to a court's satisfaction that the reasons for the new policy are *better* than the reasons for the old one; it suffices that the new policy is permissible under the statute, that there are good reasons for it, and that the agency *believes* it to be better, which the conscious change of course adequately indicates.

[5] Pursuant to Section 1062 of the Dodd-Frank Act, the transfer of authority to the new CFPB will take place on the "Designated Transfer Date," a date established by the Secretary of the Treasury in consultation with the Board and other agencies. The Designated Transfer Date has been set for July 21, 2011. *Designated Transfer Date*, 75 Fed. Reg. 57,272 (Sept. 20, 2010). Thus, the Board will possess full authority to implement Section 904(c) on April 21, 2011. There is no support in the Dodd-Frank Act for a suggestion that the Board will not retain full statutory authority to implement Section 904(c) prior to the Designated Transfer Date. Such an interpretation would improperly read the effective date provision out of the statute and would assert that Congress had transferred authority to an agency that does not yet formally exist.

Moreover, the Board does not need any separate grant of authority from Section 904(c) or any other source in order to change the rules it has promulgated to implement the EFTA. Under the *State Farm* and *Fox Television* decisions, the Board would retain full authority to change its conclusion about the appropriate interpretation and application of the network exclusivity and routing provisions if subsequent events were to cause the Board to conclude that its initial approach should be reconsidered.

Conclusion

In promulgating the Final Rule, the Board should exercise its discretion to exclude three-party networks from the scope of the network exclusivity and routing provisions. It should follow the approach advocated by Senator Durbin in his Comments, and "monitor whether exclusivity arrangements in the three party systems are having a detrimental effect on competition and choice in the debit card system . . . ." If the Board were subsequently to conclude that an exclusivity arrangement was having such an effect, then it could modify its rules at that time based on the facts.