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General Counsel's Office
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November 18, 2010

Via Electronic Mail

Louise L. Roseman
Director
Division of Reserve Bank Operations
and Payment Systems
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551

Re: Implementation of Exclusive Debit Card Routing Provisions of Durbin Amendment

Dear Ms. Roseman:

American Express Company ("American Express") respectfully submits the following information to the Board of Governors of the Federal Reserve System (the "Board") for its consideration in developing its Notice of Proposed Rulemaking with respect to the exclusive debit network routing provisions of the Durbin Amendment (the "Exclusive Routing Amendment").¹

The Exclusive Routing Amendment directs the Board to promulgate regulations that prohibit an issuer or payment card network from restricting the number of payment card networks on which an electronic debit transaction may be processed to (i) one network, or (ii) two or more networks that are owned, controlled or otherwise operated by

¹ EFTA § 920(b).

affiliated persons or networks affiliated with the issuer of the debit card.² The Exclusive Routing Amendment also provides that an issuer or payment card network shall not inhibit the ability of a merchant who accepts electronic debit transactions to direct the routing of those transactions for processing over any payment card network that may process such transactions.³ American Express issues prepaid cards, whose use by a cardholder would fall within the definition of “electronic debit transaction.”⁴

American Express has a discrete, but critical, concern with the potential application of the Exclusive Routing Amendment. American Express submits that the Amendment does not create a right of access by which third parties may access closed-loop payment networks, such as the American Express network, to acquire transactions from merchants. As the Board is aware, there are generally two types of payment networks that exist in the United States: (i) open-loop payment networks, and (ii) closed-loop payment networks. All payment card networks permit various third party entities to *process* (i.e., route) transactions for merchants; however, not all payment networks permit third party entities to *acquire* such transactions from merchants. While open-loop networks authorize third parties to both *acquire* merchants and *process* the transactions in

² EFTA § 920(b)(1)(A)(i)-(ii). Section 920(b)(1)(A) states that the Board must “prescribe regulations providing that an issuer or payment card network shall not directly or through any agent, processor, or licensed member of a payment card network, by contract, requirement, condition, penalty, or otherwise, restrict the number of payment card networks on which an electronic debit transaction may be **processed** to: (i) 1 such network; or (ii) 2 or more networks which are owned, controlled, or otherwise operated by (I) affiliated persons; or (II) networks affiliated with such issuer.” (Emphasis added).

³ EFTA § 920(b)(1)(B). Section 920(b)(1)(B) states that the Board must “prescribe regulations providing that an issuer or payment card network shall not, directly or through any agent, processor, or licensed member of the network, by contract, requirement, condition, penalty, or otherwise, inhibit the ability of any person who accepts debit cards for payments to direct the **routing** of electronic debit transactions **for processing** over any payment card network that may process such transactions.” (Emphasis added).

⁴ EFTA § 920(c)(5) states the term ‘electronic debit transaction’ means a transaction in which a person uses a debit card. The definition of “debit card” under § 920(c)(2)(B) includes certain general-use prepaid cards.

which those merchants engage, closed-loop networks only authorize third parties to *process* transactions for merchants that participate in the payment network. Closed-loop networks do not authorize third parties to *acquire* merchants to accept payments on those networks.

As the Board develops its Notice of Proposed Rulemaking, the distinction between processing (i.e., routing) of electronic debit transactions and the actual acquiring of electronic debit transactions is critical. The text of the Exclusive Routing Amendment does not require a closed-loop network, such as American Express, to open up its closed-loop network and provide third parties with a right to acquire, as opposed to simply route, transactions from merchants. If it had intended that closed-loop systems provide third parties with such an extraordinary right of access, Congress could readily have included provisions in the Amendment that would have explicitly created such a right and that defined the terms and conditions under which the closed-loop network would be compelled to allow third parties a right of access to acquire transactions. Indeed, inclusion of such implementation provisions would have been necessary to address constitutional problems under the Takings Clause and Due Process Clause that otherwise would have arisen if a right of access to closed-loop systems had been created. Congress' failure to include such provisions confirms that it did not intend to create a right of access to closed-loop systems for merchant acquisition. To the contrary, the legislative history demonstrates that the Exclusive Routing Amendment sought to preserve competition in the routing of PIN-based debit transactions across multiple open-loop payment networks, not to provide third parties with a mandatory right of access to closed-loop networks.

Any interpretation of the Exclusive Routing Amendment that required American Express to open its network and permit acquisition of prepaid card transactions by third parties would exceed the Board's statutory authority. Therefore no provision that would have that effect should be included in the Notice of Proposed Rulemaking.

Background – The American Express Closed-Loop Network

American Express operates a vertically-integrated, closed-loop payment network, which distinguishes its system from the open-loop payment networks of its competitors. Unlike open-loop networks, which do not issue cards and do not have card acceptance agreements with merchants, American Express both manages the American Express Card-issuing side of the business and enters into direct, bilateral agreements with merchants concerning their acceptance of its cards.⁵ The resulting "closed-loop payment network" makes American Express quite different from the open-loop payment networks in which, for any given transaction, the merchant relationship and the cardholder relationship are likely to be with different bank issuers and merchant acquirers.

To support a merchant's *processing* of American Express Cards, including prepaid cards, American Express can enable the merchant to process such transactions directly with American Express, or the merchant can choose to route transactions for processing through various authorized third party processors that have certified to American Express' proprietary transaction specifications. Either way, American Express

⁵ Although American Express has licensed a small number of U.S. banks to issue charge and credit cards on the American Express network, American Express retains the direct transaction acquisition relationship with all merchants in the United States.

maintains its closed-loop system because the direct acquiring relationship with the merchant remains with American Express.

Utilizing the benefits of its closed-loop network, American Express is able to gather unique information that matches merchants with their cardholder customers and prospective customers, and to make merchant-related and other offers to cardholders that, based on prior behavior, the cardholder is likely to find attractive.⁶ These and other attributes, including the high regard in which the American Express brand is held around the world, make the American Express network distinctive. The Company relies upon its unique closed-loop structure to compete effectively against the dominant open-loop payment networks.⁷

The Exclusive Routing Amendment Does Not Create a Mandatory Right of Access to the American Express Closed-Loop Network

American Express submits that the Exclusive Routing Amendment does not grant third parties a mandatory right of access to its closed-loop payment network to acquire merchant transactions, and that the Board has no statutory authority to require such

⁶ Information is aggregated and used in compliance with legal requirements related to consumer privacy.

⁷ The courts have recognized the importance of the competition that closed-loop systems provide to the open-loop networks. As Judge Jones stated in her decision in *United States v. Visa U.S.A., Inc.*, 163 F.Supp.2d 322, 395-96 (S.D.N.Y. 2001):

“Because American Express and Discover are closed-loop systems that deal directly with merchants, those brands have the infrastructure to collect data and details about spending that many consider superior to defendants' [Visa and MasterCard] capabilities. Utilizing this resource, they could offer their bank issuers, merchants and consumers sophisticated data mining skills to provide targeted promotions to various consumer segments.”

Discover maintains direct relationships with many merchants in the United States that participate in the Discover payment network, but has in recent years permitted some third parties to act as merchant acquirers for its network. As a result, American Express currently has the only remaining significant network that is entirely closed-loop in its merchant relationships in the United States.

access in its implementing rule. This conclusion is supported by the language, the structure, and the legislative history of the Amendment. It also avoids the constitutional problems that otherwise would be presented by an interpretation which suggested that Congress had given third parties a right to access a proprietary closed-loop system, without payment of compensation, and to compete with the network for its own merchant customers.

The text of the statute does not mandate that the Board provide third parties an extraordinary right of access to enter vertically-integrated, closed loop networks and permit them to become acquirers of prepaid card transactions from merchants. As set forth above, neither Sections 920(b)(1)(A) nor 920(b)(1)(B) specify that payment card networks must provide third parties a right to *acquire* transactions from merchants that participate on a closed-loop network. Indeed, the text of both subsections refers to the *processing* of electronic debit transactions. In fact, like other closed-loop networks, American Express permits merchants to route transactions for processing through any one of several dozen authorized third party processors that have certified to American Express' proprietary transaction specifications. However, these processors do not ultimately acquire any of the prepaid card transactions. All transactions are acquired by American Express and are routed to it for acquisition.

When Congress wants to create a mandatory right of access to another entity's network, it knows how to draft language that explicitly creates such a right. For example, in the Telecommunications Act of 1996, Congress gave other telecommunications carriers a mandatory right of access (interconnection) to the local loops of the monopoly telecommunications carriers. In 47 U.S.C. § 251(c)(2)(A), Congress imposed on these

carriers “[t]he duty to provide, for the facilities and equipment of any requesting telecommunications carrier, interconnection with the local exchange carrier’s network . . . for the transmission and routing of telephone exchange service and exchange access” This provision imposed a clear duty on the telecommunications carrier to provide access to third parties. There is no similar language in the Exclusive Routing Amendment.

Congress further provided in 47 U.S.C. § 251(c)(2)(D) that this duty to provide access shall be “on rates, terms, and conditions that are just, reasonable, and nondiscriminatory” Inclusion of this provision was necessary to avoid the constitutional problems that otherwise would have arisen under the Takings Clause and Due Process Clause of the Constitution if Congress had given a third party a right of access to another entity’s property and did not provide for payment of a reasonable access fee. In light of the decade of litigation over takings claims and access fees that followed passage of the Telecommunications Act, Congress could have been expected to include a process for determining an appropriate access fee in the Exclusive Routing Amendment if it had intended to create a mandatory right of access to closed-loop systems.⁸ The absence of such provisions is powerful evidence that the Exclusive Routing Amendment did not create such a right.

⁸ In the Telecommunications Act, Congress created elaborate, multi-stage mechanisms to determine the appropriate access fees. See 47 U.S.C. §§ 251(d), 252. Even if mandatory access could constitutionally be required, American Express would have the right under the Due Process Clause to charge third parties a reasonable fee for access to its network. See e.g., *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). Unlike the interchange fee provision of the Durbin Amendment, the Exclusive Routing Amendment contains no language that would authorize or guide the Board in establishing a reasonable fee. As a result of the statutory silence, the Board would encounter a series of extremely difficult implementation problems if it attempted to determine an appropriate access fee.

This conclusion is confirmed by analysis of the concerns that Congress did intend the Exclusive Routing Amendment to address. These concerns involved the acquisition and processing of PIN-debit transactions in open-loop payment networks in which substantial competition to *acquire* transactions has long existed among PIN-debit networks -- networks that, by design, are not vertically integrated closed-loop systems.⁹

As Senator Durbin has explained, Congress sought to preserve competition for routing of PIN-based debit transactions because price competition for routing of these PIN-based transactions had diminished as a result of certain open-loop payment networks entering into exclusive arrangements with bank issuers which, based on the manner in which the issuer enables the PIN-debit card, require that merchants must use the online PIN network affiliated with the open-loop payment network as the exclusive route for these PIN debit transactions.¹⁰ We believe that Congress' focus on preserving competition among the already open-loop PIN-debit networks is a strong indication of why the statute is silent on the complex third party access issues that Congress did address in the Telecommunications Act. Congress did not include language in the Exclusive Routing Amendment regarding access to closed-loop systems because the statute does not create such a right.

Conclusion

Substantial constitutional questions would arise under the both the Takings Clause and the Due Process Clause of the Constitution if the Exclusive Routing Amendment

⁹ See July 23, 2010 Visa Presentation to the Federal Reserve on Debit Card Regulation at 7.

¹⁰ See *Durbin Statement on TCF's Court Challenge of Interchange Law – Tuesday, October 12, 2010* <http://durbin.senate.gov/showRelease.cfm?releaseId=328221>.

were interpreted as giving third party merchant acquirers a mandatory right of access to enter American Express' closed-loop payment network to acquire prepaid card transactions. The Board need not address these difficult issues, however, because it should conclude that the language of the Amendment does not create such a right of access.

For the reasons stated above, the Board should conclude that it does not have the statutory authority to provide third parties with a mandatory right of access to a closed-loop payment network such as the American Express network. The forthcoming Notice of Proposed Rulemaking should not include any provisions that would have that effect.

Thank you for your consideration of this information. If you have any questions or wish to discuss the comments, please do not hesitate to contact me at 212-640-5805.

Respectfully submitted,



Jason D. Halpern
Vice President and Senior Counsel