No. 14-200

In the Supreme Court of the United States

NACS (FORMERLY KNOWN AS NATIONAL ASSOCIATION OF CONVENIENCE STORES), NATIONAL RETAIL FEDERATION, FOOD MARKETING INSTITUTE, MILLER OIL CO., INC., BOSCOV'S DEPARTMENT STORE, LLC, AND NATIONAL RESTAURANT ASSOCIATION,
Petitioners,

V.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

PETITIONERS' REPLY BRIEF

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TABLE OF CONTENTS

PAGE

ARGUMENT 1

CONCLUSION 12

TABLE OF AUTHORITIES

CASES **PAGE(S)**

Deck v. *Missouri*,
544 U.S. 622 (2005) 3

ExxonMobil Gas Mktg. Co. v. *FERC*,
297 F.3d 1071 (D.C. Cir. 2002) 5, 6

Medtronic, Inc. v. *Lohr*,
518 U.S. 470 (1996) 3

STATUTES

Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) (codified at 15 U.S.C. § 1693o-2)

15 U.S.C. § 1693o-2(a)(2) 9

15 U.S.C. § 1693o-2(a)(4)(B) 6

15 U.S.C. § 1693o-2(a)(4)(B)(i).....12

15 U.S.C. § 1693o-2(a)(4)(B)(ii).....1, 2, 12

15 U.S.C. § 1693o-2(c)(5).....3, 9

FEDERAL REGISTER

Debit Card Interchange Fees and Routing: Final Rule, 76 Fed. Reg. 43,394 (July 20, 2011) (codified at 12 C.F.R. pt. 235)..... 1, 3-4, 7

Debit Card Interchange Fees and Routing:
Proposed Rule, 75 Fed. Reg. 81,722 (Dec. 28, 2010) (codified at 12 C.F.R. pt. 235).... 2-3, 7-8

PETITIONERS' REPLY BRIEF

The Durbin Amendment prohibits banks from recovering through the debit interchange fee any cost that is "not specific to a particular electronic debit transaction." 15 U.S.C. § 1693o-2(a)(4)(B)(ii). Reversing its own understanding of this provision's plain meaning, the Board of Governors of the Federal Reserve System (the "Board") adopted a Final Rule that provides exactly the opposite. Issuers can recover any costs that are "specific to effecting debit card transactions as a whole," including the general costs of operating a debit card program, such as network hardware, software, and labor. 76 Fed. Reg. 43,394, 43,426 (2011). The Petition demonstrated that certiorari is warranted because the Rule has vast significance for the economy; because the Rule cannot be reconciled with the statute's plain language; and because the D.C. Circuit committed a gross methodological error in affirming the Rule by treating the statute as conferring general ratemaking authority on the Board. Five amicus briefs have been submitted in support of the Petition, reinforcing each of those points. The Board's answers are not persuasive.

1. The Rule governs roughly 100 million transactions by approximately eight million different entities for tens of millions of customers—*every single day*. The Rule authorizes banks to impose at least $3 billion annually in unlawful interchange fees that are then passed on to consumers. Although the Rule reduces the previous average interchange fee in many instances, BIO 24, it actually caused interchange fees to go *up* substantially for many small-ticket purchases, which represent more than 40% of

debit transactions. *See* 7-Eleven Amici Br. 17-21. The Rule's significance is only growing, because the volume of debit transactions is expanding rapidly. *See* Pet. 33-44; Wal-Mart Amicus Br. 9-11; Ahold U.S.A. Amicus Br. 7-11.

The Solicitor General's claim that the Rule is not of sufficient "importance to warrant this Court's review," BIO 22, is therefore not serious. And the government's statement that the D.C. Circuit's ruling "would be unlikely to affect the disposition of any other case," *id.*, is true only in a sense that supports granting certiorari: This case has already brought together the universe of likely plaintiffs, combining challenges of thousands of separate merchants. This Petition is accordingly the Court's only real opportunity to decide the Question Presented. *See* Pet. 34-35.

2. In requiring the Board to establish standards for interchange fees, Congress prohibited the Board from permitting issuers to recover costs "which are not specific to a particular electronic debit transaction." 15 U.S.C. § 1693o-2(a)(4)(B)(ii). The Board had no trouble understanding the statute's plain meaning in its Notice of Proposed Rulemaking, which provided that the Board would "not consider costs that are common to all debit card transactions and could never be attributed to any particular transaction (i.e., fixed costs), even if those costs are specific to debit card transactions as a whole." 75 Fed. Reg. 81,722, 81,736 (2010). The Final Rule reversed course, declaring by *ipse dixit* that the prohibition is instead limited to the trivial category of "costs that are not incurred in the course of effecting *any* electronic debit transaction," whereas fixed costs

are recoverable because they are supposedly "specific to *each and every* electronic debit transaction. 76 Fed. Reg. at 43,426-27 (emphasis added). On that basis, the Rule permits issuers to pass on "all costs *related to*" effecting debit card transactions as a whole. *Id.* (emphasis added).

The Petition demonstrated that the Rule is directly contrary to the ordinary, accepted meaning of the statutory language. Costs are only "specific to a particular" item if they are "restricted" to the "individual" item. Pet. 19-20. Further, the statute defines an "electronic debit transaction" to refer to a single event: "a transaction in which a person uses a debit card." 15 U.S.C. § 1693o-2(c)(5). So, as the Board recognized in the NPRM, *see* 75 Fed. Reg. at 81,736, the Durbin Amendment bars issuers from recovering costs that do not arise from individual transactions, but rather are common to *all* transactions.

That is also how the statutory terms are understood in ordinary usage: the costs "specific to a particular meal" do not include the stove; the costs "specific to a particular phone call" do not include the phone; and (as the D.C. Circuit itself pointed out, Pet. App. 31a), the costs specific to a particular "shoe sale" do not include the store's rent. Pet. 20-21. This Court's decisions uniformly use the same language the same way. Pet. 21 (citing *Deck* v. *Missouri*, 544 U.S. 622, 629, 633 (2005); *Medtronic, Inc.* v. *Lohr*, 518 U.S. 470, 500-01 (1996)). When Congress instead wanted to identify costs that were more broadly "related to" a particular activity, it did so expressly. *See* Pet. 21-22.

The Petition thus demonstrated that the prohibition's plain meaning prevents issuers from recovering costs that are not restricted to an individual transaction in which a person uses a debit card. Pet. 19-20. Congress obviously included the prohibition to stop the Board from doing exactly what it did in the Final Rule: permitting issuers to inflate the interchange fee to recover the billions of dollars spent to make it possible to perform electronic transactions in the first place, such as computer system and software costs. *See* Pet. 28-29.

The Petition also demonstrated that the Board's interpretation is utterly incoherent as a result of its inconsistency. *See* Pet. 27-28. The Board permitted issuers to recover fixed costs that are not meaningfully distinguishable from other costs that it *excluded* precisely because they are "incurred without regard to whether, how often, or in what way an electronic debit transaction will occur," 76 Fed. Reg. at 43,428. Thus, at the same time it permitted fixed costs, it prohibited recovery for "card production and delivery costs," *id.* at 43,427, and membership fees for card networks, *id.* at 43,428. Even the D.C. Circuit recognized that the Board was unable to explain why, given its reading of the prohibition, it had precluded banks from recovering their general costs of monitoring transactions for fraud. Pet. App. 38a.

3. The Rule is valid under *Chevron* only if it identifies some ambiguity in the statutory prohibition and interprets it coherently. But the Solicitor General does not even try to make that argument. Neither did the Board. And—*critically*—neither did the D.C. Circuit. To the contrary, the court of appeals recognized that the Board had interpreted "the

term 'specific to a particular . . . transaction' as in fact allowing recovery of many costs not *literally* 'specific' to any one 'particular' transaction." Pet. App. 16a (emphasis added). That is just a back-handed acknowledgment that the Board was not really interpreting an ambiguity in the statutory text. The court of appeals nonetheless approved the Rule only by eschewing ordinary *Chevron* deference in favor of the heightened deference reserved for proceedings similar to rate-making arising from open-ended delegations of authority; provisions that—as the Board repeatedly pointed out—look nothing like the Durbin Amendment. *See* Pet. 24-26; *see generally* Retail Litigation Center Amicus Br. 5-12.

The government's weak attempt to contest the analytical framework that the D.C. Circuit applied is meritless. The court *expressly* rested its decision on the "special deference" applicable to statutes that confer authority akin to ratemaking. Pet. App. 30a. The Solicitor General's representation that "the court supported [its] conclusion with a citation to a traditional *Chevron* case," BIO 22, is false. Here is what the D.C. Circuit actually said:

> Given the Board's expertise, we see no basis for upsetting its reasonable line-drawing. *See ExxonMobil Gas Marketing Co.* v. *Federal Energy Regulatory Commission*, 297 F.3d 1071, 1085 (D.C. Cir. 2002) ("We are generally unwilling to review line-drawing . . . unless a petitioner can demonstrate that lines drawn . . . are *patently unreasonable, having no relationship to the underlying regulatory problem*." (internal quotation marks omitted)).

Pet. App. 33a (emphasis added). In the cited discussion, the *ExxonMobil* ruling applied FERC's "wide discretion" where to draw lines between "gathering and transportation" in gas delivery. *See ExxonMobil*, 297 F.3d at 1085.[1]

4. The government's defense of the ruling below—which, as noted, does not identify any ambiguity in the statute that could be the basis for deference to the Board's interpretation—lacks merit. The Solicitor General's arguments attack (i) the very distinction that Congress drew between recoverable costs and those that are not specific to a particular transaction, and (ii) whether the statutory prohibition includes all "fixed" costs, as opposed to some other measure. Neither is an excuse for failing to implement the Act's plain meaning.

First, the Solicitor General repeats the Board's assertion that the prohibition should not extend to "'all costs that are not able to be specifically identified to a given transaction,'" because it would be logistically difficult for each issuer to segregate precisely which costs it incurs in the course of an individual transaction. BIO 17 (quoting 76 Fed. Reg. at 43,426). This is nothing more than a claim that implementing Congress's explicit direction—i.e., identi-

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[1] "As a preface to its analysis" in a distinct section of the opinion, the court invoked *Chevron* and said that the Rule was "reasonable." BIO 21. But that is only because it applied *Chevron* to an analytically separate question—whether the statute permitted recovery of *any* costs besides those addressed in Section 1693o-2(a)(4)(B). *See infra* at 10 n.3.

fying which costs are not "specific to a particular transaction"—is hard. Thankfully, the Board solved that problem by not requiring issuer-specific cost determinations. Instead, the Board itself estimated recoverable costs across the industry and identified a safe harbor that permits every issuer to charge up to the maximum fee without having to track its own costs. *See* Pet. 10-11. The Board permitted issuers to "retain the difference between their [actual] costs and the cap." 76 Fed. Reg. at 43,434.

Second, the government argues that petitioners' interpretation of the prohibition lacks merit because "the line between 'fixed' and 'variable' costs is illusory in this context, as *all* of the 'fixed' ACS costs at issue here (such as labor and equipment) will vary over the long run depending on the number of transactions that an issuer performs." BIO 18. But the Board itself had no difficulty drawing this exact distinction in its NPRM, which permitted recovery of average variable costs while, at the same time, recognizing that "fixed costs" could *never* be "specific to a particular transaction." *See* 75 Fed. Reg. at 81,734; *see also* 76 Fed. Reg. at 43,426 (recognizing that NPRM "proposed to exclude from allowable costs those costs that cannot be attributed to any identified transaction (referred to as 'fixed costs' in the proposal"). In any event, even if it were possible to treat costs such as labor and equipment counterintuitively as "variable" costs, the only *relevant* point is that you *cannot* consider them "specific to a particular electronic debit transaction." Thus, the debate over precisely what kinds of costs are "fixed" rather than "variable" makes no difference under the statute's plain terms. However characterized, the stat-

ute precludes those that cannot be specifically attributed to an identifiable transaction.

Put another way, the Question Presented is whether the Rule violates the statutory prohibition by permitting issuers to recover costs that merely "relate" in some general sense to debit transactions. The question is *not* what label the Board will put on costs that are or are not "specific to a particular transaction" if this Court invalidates the Rule. The NPRM permitted issuers to recover their "average variable cost"—i.e., the "per-transaction value" of those costs that "vary with the number of transactions." 75 Fed. Reg. at 81,735. Perhaps the Board will return to that measure; maybe it will use another. What matters is that the Rule the Board *did* adopt is invalid.

The same point answers the government's assertions that "[t]he court of appeals found it to be undisputed that" the statute did not limit issuers to recovering the "marginal cost of each particular transaction," BIO 15, 18; and that "the court of appeals did not perceive petitioners" to make the argument that the statutory prohibition permits recovery of only a cost that is "'unique to a single . . . transaction,'" *id.* at 19. Again, the precise dividing line between fixed and marginal or variable costs makes no difference. The Board cannot erase the line altogether and permit issuers to recover all their costs that are merely related to debit transactions.[2]

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[2] The government's lawyerly formulation that the court of appeals "perceive[d]" that to be petitioners' position reveals that it knows perfectly well that in the administra-

(Continued …)

Fourth, the government argues that the Rule is supported by what it characterizes as "the Act's overarching instruction that fees be 'reasonable and proportional to the cost incurred by the issuer with respect to the transaction.'" BIO 19. The Solicitor General highlights the phrases "reasonable and proportional" and "with respect to," which (he maintains) confer "exceptionally broad authority." BIO 14. In fact, that provision makes clear that the Board may not permit issuers to recover their costs that are common to debit transactions as a whole, rather than costs that arise from individual transactions. It actually states in full: "The amount of any interchange transaction fee that an issuer may receive or charge with respect to *an electronic debit transaction* shall be reasonable and proportional to *the cost* incurred by the issuer with respect to *the transaction*." 15 U.S.C. § 1693o-2(a)(2) (emphasis added). *See* Durbin Amicus Br. at 15-16. As discussed above, the statute defines "an electronic debit transaction" to mean a single transaction by one person using one card. 15 U.S.C. § 1693o-2(c)(5). But in any event, the statutory prohibition then further qualifies the Board's authority by specifically excluding the costs that are not "specific to a particular" transaction.

Fifth, the government then offers a hypothetical of its own: when "four neighbors on the same floor of an apartment building schedule a painter to come on

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tive proceedings and in the court below, petitioners consistently argued that the statute excluded costs not incurred in connection with a particular transaction.

the same day to each of their homes," it says that the "costs 'specific to a particular' painting task" for each neighbor would reasonably include "a quarter of his travel expenses." BIO 19. Petitioners disagree. The cost of driving to work is not specific to a particular apartment, and it only begins to seem so because the hypothetical is skewed by assuming the customers are "neighbors," and all the painting happens on "the same floor" of an apartment building on "the same day." The more apt hypothetical is that the painter sends each of those customers a bill that includes his assumed share of the cost of his office space, the salary he pays the assistant who answers his phone, both of their computers, the software he uses to track appointments, his work truck, his painter's bib, and his ladder. No reasonable customer would consider those costs "specific" to their "particular" job.[3]

5. The Solicitor General finally warns the Court that it should not "assume" that its ruling would

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[3] The government also defends the Board's decision to recognize a third category of costs that is not mentioned in the statute: "costs specific to a particular transaction" that are not ACS costs. BIO 16. The D.C. Circuit correctly recognized that this argument is analyzed under *Chevron*. *See* Pet. App. 19a. But whether or not this implied category of costs exists, everyone agrees it cannot include costs that are expressly prohibited by the statute. In any event, the Board's reading is implausible: Congress went to the trouble of specifying those costs that must be recovered and others that may not be recovered; if it wanted to grant the Board authority whether to recognize a broad array of other costs, it would not have granted that authority by silence. *See* Pet. 23-24.

"compel" the Board not to permit recovery of fixed costs, BIO 24, because the Board "would retain significant discretion" to reach the same result another way, *id.* at 23. This is the unattractive assertion that an agency may be so committed to reaching a particular result that it does not much care what the statute says or what this Court decides. Even if that were true, it would not be a basis for refusing to invalidate an unlawful regulation and plainly reminding both the Board and the court of appeals of the importance of adhering to the statute Congress enacts.

In any event, the Solicitor General's warning is a bluff. He gives no reason to believe that the Board actually *would* adopt his hypothetical reading of the Act. Petitioners' hope and expectation is that the Board would follow a ruling of this Court that Congress precluded issuers from recovering a sweeping array of fixed costs. And nothing should prevent the Board from considering merchants' comments before the Board that the final interchange fee should be even lower than the 7 to 12 cent cap originally proposed by the Board.

The Solicitor General's interpretation also would not survive review under *Chevron*. He hypothesizes that the Board could include "fixed costs" in "the incremental cost incurred by the issuer for the role of the issuer in the authorization, clearance, or settlement of a particular electronic debit transaction," which issuers may recover under 15 U.S.C. § 1693o-2(a)(4)(B)(i). There are two easy answers that likely explain why the Board did not suggest this interpretation below. First, on any ordinary reading, "fixed" costs are the opposite of the "incremental cost . . . of

a particular electronic debit transaction," not the same. *Id.* Second, the statute expressly prohibits issuers from recovering costs "not specific to a particular electronic debit transaction"—full stop. *Id.* § 1693o-2(a)(4)(B)(ii). Nothing in that prohibition's use of the word "other" changes that result. Congress plainly meant to preclude recovery of *any* cost that was not specifically incurred in connection with a particular transaction.

CONCLUSION

For the foregoing reasons, as well as those set forth in the Petition, certiorari should be granted.

Respectfully submitted,

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