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Durbin Amendment to the Dodd Frank Act: Two Caps are Better than One for Debit Card Interchange Fees

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DURBIN AMENDMENT TO THE DODD FRANK ACT: TWO CAPS ARE BETTER THAN ONE FOR DEBIT CARD INTERCHANGE FEES

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I. INTRODUCTION

Ignorance is not always bliss. Every day in the United States, there are over one hundred million debit card transactions completed to purchase goods or services;[1] however, most consumers do not know or even care *how* they work–they just care *that* they work. This ignorance allows the card-issuing banks to charge "hidden" fees, known as interchange fees. Every time a debit card is swiped,

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1. *See* Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,723 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235). There were 37.9 billion transactions in 2009. *Id.*

fees are deducted from the amount taken out of the consumer's bank account,[2] and the remainder is deposited into the merchant's bank account. Since, normally, neither merchants nor consumers are fully aware of the exact cost of the debit card interchange fees, the card-issuing bank can abuse these fees.[3] Even though merchants are aware of the fees, they likely will not stop accepting debit cards because they need to remain competitive in the market, and because consumers want and expect to be able to use them.

Before the Durbin Amendment, interchange fees were a percentage of the transaction cost and could be negotiated between the merchants and the networks, such as Visa and MasterCard.[4] Obviously, larger merchants with a greater number of transactions were able to negotiate lower percentage fees than smaller merchants.[5] Senator Richard Durbin and other members of Congress saw a problem with this, so they proposed an amendment to the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), seeking to "help small businesses, merchants, and consumers by providing relief from high interchange fees for debit card transactions."[6] The Durbin Amendment gave the Federal Reserve Board (Board) the rulemaking power to create regulations for debit card interchange fees so that they "shall be *reasonable and proportional* to the cost incurred by the issuer with respect to the transaction."[7] The Board was tasked to take into consideration the cost per transaction for the card issuer.[8] The final rule adopted by the Board provides that the interchange

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2. Fees are not added to the purchase price stated when the consumer swipes his or her card, but instead are deducted from the price stated, so the merchant does not get the full transaction price. *See* Patrick C. McGinnis, *Misguided Regulation of Interchange Fees: The Consumer Impact of the Durbin Amendment*, 25 LOY. CONSUMER L. REV. 285, 286 (2013).

3. This was true before and after the Durbin Amendment. *See infra* Part III.C.

4. *See* Richard A. Epstein, *The Constitutional Paradox of the Durbin Amendment: How Monopolies are Offered Constitutional Protections Denied to Competitive Firms*, 63 FLA. L. REV. 1307, 1315 (2011). The interchange fees were not negotiated between merchants and the card-issuing bank. *Id.* Networks also had the ability to create categories based on the type of merchant or the transaction volume. *See* Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81,723.

5. A merchant is able to negotiate the fees with its bank, and the merchant's bank and the card-issuing bank can negotiate their fees. *Interchange Myths and Facts*, MASTERCARD, www.mastercard.com/us/merchant/pdf/021208 MythsFacts.pdf (last visited Apr. 6, 2014). To avoid thousands of separate negotiations, MasterCard sets "default" interchange rates. *Id.*

6. 156 CONG. REC. S4839 (daily ed. June 10, 2010) (statement of Sen. Richard Durbin) ("My amendment sought to give small businesses and merchants and their customers across America a real chance in the fight against the outrageously high swipe fees charged by Visa and MasterCard credit card companies."); *see also* 156 CONG. REC. S3695 (daily ed. May 13, 2010) (statement of Sen. Richard Durbin).

7. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068 (2010) (emphasis added).

8. *See id.*; Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81,733.

fees charged cannot exceed the sum of $0.21, plus five basis points of the value of the transaction, as a fraud-prevention adjustment.[9]

This Note does not suggest changing the goals of the Durbin Amendment, but instead suggests an alteration to the regulations created by the Board. The regulations suggested in this Note aim to better match the Amendment's goals of being "reasonable and proportional" while taking into consideration the card issuer's cost per transaction. This Note suggests placing a double cap on interchange fees.[10] The suggested fees would be *reasonable* because they would cap the total amount that can be charged based on the cost per transaction, and would be *proportional* because they would base the fees on a capped percentage of the purchase price. This Note does not suggest an exact value of either cap, because it would require more information to ensure that the caps capture the actual cost per transaction while taking into account the number of transactions with percentages that are potentially below the actual cost per transaction. This Note focuses primarily on the three parties participating in the two-sided market: (1) the merchant, (2) the consumer, and (3) the card-issuing bank. There are other parties involved in the debit card transfer, but their role in the realm of interchange fees is minimal.[11] These three parties are in a two-sided market because the card-issuing bank's goal is to make sure that both merchants and consumers want to use its card. This is a careful balancing act because both merchants' and consumers' decisions are affected by fees. If the fees are too high then merchants will not accept the card, and if merchants do not accept the card, then consumers will not want the card.

Part II examines the economic background and implementation of the Dodd-Frank Act and then explains the Durbin Amendment's key parts. Part III explains how a debit card transaction takes place and the two-sided nature of these transactions. It also discusses the hidden nature of the debit card interchange fees. Part IV discusses the effects that the Durbin Amendment has on each of the parties, including: merchants' cost savings or lost profits on low-priced items, banks' loss of revenue generation, the effect on exempted banks, and the possibility of switching to other methods of payment.

Part V discusses the advantages and disadvantages of some potential alternatives. This Note discusses five possible alternatives to this problem: (1) leave the Durbin Amendment "as is;" (2) repeal the Durbin Amendment and return to a pre-amendment status with no regulation; (3) have no interchange fees; (4) change the Amendment

9. Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,404 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235).

10. *See infra* Part V.E.

11. *See infra* Part III.A.

to cap the fees on the percentage of the sale; or (5) change the Amendment to cap fees on the percentage of the sale price while capping the total interchange fees. Ultimately this Note will suggest an alteration to the Durbin Amendment that caps both the fees based on a percentage of the sale price and the total amount allowed in interchange fees, so that the regulation more closely tracks the Amendment's goal of being "reasonable and proportional."

II. DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT

A. History of the Financial Crisis and Implementation of the Dodd-Frank Act

The U.S. Government passed the Glass-Steagall Act after the Great Depression, which created banking regulations.[12] However, in 1999, President Clinton repealed many of the banking regulations that were established under the Glass-Steagall Act.[13] Many people believe that one cause of the 2008 financial crisis was the deregulation of the banking industry and the fact that new regulations were needed to rehabilitate the economy.[14]

On July 21, 2010, the Dodd-Frank Act became law.[15] The Dodd-Frank Act's goal, as stated in its short title, is "[t]o promote the financial stability of the United States by improving accountability and transparency in the financial system, to end 'too big to fail', to protect the American taxpayer by ending bailouts, to protect the consumers from abusive financial services practices, and for other purposes."[16] Whether the Dodd-Frank Act is meeting this goal is a topic for many other articles.

B. Durbin Amendment

A few months after the Dodd-Frank Act was passed, Senator Durbin recommended an addition, seeking to help small businesses.[17] This addition can be found in section 1075 of the Dodd-Frank Act, entitled "Reasonable Fees and Rules for Payment Card Transactions," but is commonly referred to as the Durbin Amendment.[18] The

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12. *See* McGinnis, *supra* note 2, at 292.

13. *Id.*

14. *See id.* at 292-93.

15. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1, 124 Stat. 1376, 1376 (2010); McGinnis, *supra* note 2, at 293.

16. Dodd-Frank Act § 1.

17. *See* 156 CONG. REC. S4839 (daily ed. June 10, 2010) (statement of Sen. Richard Durbin).

18. Dodd-Frank Act § 1075.

Durbin Amendment, which took effect on October 1, 2011, adds section 920 to the Electronic Fund Transfer Act (EFTA).[19]

Before the Dodd-Frank Act, debit networks incorporated an ad valorem percentage to determine the interchange fees for each transaction.[20] Networks also had the ability to create categories based on the type of merchant or the transaction volume.[21] Before the Durbin Amendment, the average interchange fee was between 1.15% and 1.35% of the transaction cost, and averaged approximately $0.47 per transaction.[22]

1. Reasonable and Proportional

The Durbin Amendment gave the Board the rulemaking power to create regulations "regarding any interchange transaction fee that an issuer may receive or charge with respect to an electronic debit transaction."[23] The principle provided as guidance to the Board was that the interchange transaction fees "shall be *reasonable and proportional* to the cost incurred by the issuer with respect to the transaction."[24]

2. Considerations

The Board was directed to consider the "functional similarity" between debit transactions and checking transactions that clear at par, as well as "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."[25] However, the Board was not to consider "other costs incurred by an issuer which are not specific to a particular electronic debit transaction."[26]

The Board requested public comment, as is required in the rulemaking process, to determine an interchange fee for debit transaction that shall be "reasonable and proportional to the cost[s] incurred."[27]

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19. *See* 15 U.S.C. § 1693 (2012); Dodd-Frank Act § 1075.

20. Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,724 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

21. *See id.* at 81,723.

22. Richard A. Epstein, *The Dangerous Experiment of the Durbin Amendment: Congress' Interchange Fee Limit is a Reckless Exercise in Price Regulation*, REG.: CATO REV. BUS. & GOV'T, Spring 2011, at 24, 25; CADY NORTH, BUSINESS IMPACT OF THE DODD-FRANK DEBIT FEE CAP, BLOOMBERG GOV'T STUD. 12 (Lisa Getter ed., 2011).

23. Dodd-Frank Act § 1075.

24. *Id.* (emphasis added).

25. *Id.* See *infra* Part III for an explanation of a check clearing at par.

26. Dodd-Frank Act § 1075.

27. Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,722 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235). *See infra* Part II.B.1.

The Board originally proposed two alternatives.[28] Alternative one combined a cap of $0.12 per transaction and a safe-harbor level of $0.07 per transaction.[29] Alternative two was simply a cap of $0.12 per transaction.[30]

The Board received over 11,500 comments from "issuers, payment card networks, merchants, consumers, consumer advocates, trade associations, and members of Congress."[31] The merchants suggested lowering the cap so that the savings could be passed along to consumers because the costs were significantly below the $0.12 cap.[32] Merchants also suggested prohibiting exclusivity arrangements to increase competition.[33] On the other hand, payment card networks, such as Visa and MasterCard, were concerned that the cap would decrease revenue for card-issuing banks, which would increase cardholder fees and decrease benefits for merchants and consumers.[34] After considering all the comments, the Board adopted a modified version of alternative two.[35]

3. Fraud Prevention

In addition, the Durbin Amendment allows the Board to create an adjustment to the interchange fees if the "adjustment is reasonably necessary to make allowance for costs incurred by the issuer in preventing fraud in relation to electronic debit transactions involving that issuer; and the issuer complies with the fraud-related standards established by the Board."[36] The goal of this addition is to encourage the card-issuing bank to take necessary actions to prevent fraud.[37]

4. Small Bank Exemption

The Durbin Amendment does not apply to any card issuer that has less than $10 billion in assets.[38] These "small issuers" will not

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28. Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81,736.

29. *See id.* at 81,736, 81,755.

30. *Id.* at 81,738, 81,756.

31. Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,394 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235).

32. *See id.* at 43,402.

33. *See id.*

34. *Id.*

35. *Id.* at 43,404.

36. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2069 (2010).

37. *Id.*; Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,404 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235).

38. 15 U.S.C. § 1693o-2 (2012). The value of the assets was raised from $1 billion to the $10 billion in order to get enough votes. Epstein, *supra* note 4, at 1326; *see also*, M. Pierce Sandwith, Note, *Debit Card Interchange Fees and the Durbin Amendment's Small Bank Exemption*, 16 N.C. BANKING INST. 223, 234-36 (2012).

have to prescribe to the Board's regulations of debit card interchange transaction fees and can instead charge whatever fee they need to or can.[39] Only three credit unions and approximately sixty banks have enough assets to be affected by the Durbin Amendment, while approximately 7500 credit unions and 7000 banks are exempt.[40] One reason for this exemption to the cap on interchange fees is that smaller banks have fewer transactions, and thus, they have fewer transactions across which they can spread their fixed costs.[41]

5. *Final Rule*

The final rule adopted by the Board is an adaptation to alternative two and provides that the interchange fees charged cannot exceed the sum of $0.21, plus five basis points of the value of the transaction, as a fraud-prevention adjustment.[42]

III. DEBIT CARDS AND INTERCHANGE FEES

When consumers want to purchase goods or services, they have a variety of payment options, including but not limited to: cash,[43] check,[44] debit card, or credit card. However, consumers are increasingly shifting to electronic payment methods such as debit and credit cards.[45] This is good news for merchants, because they have an informational asymmetry problem when consumers pay with checks,

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39. Sandwith, *supra* note 38, at 235-36.

40. Epstein, *supra* note 22, at 24.

41. *See* David C. John, *The Durbin Debit Card Interchange Fee Cap Hurts Consumers*, THE HERITAGE FOUNDATION (Mar. 17, 2011), http://report.heritage.org/wm3194.

42. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,404 (to be codified at 12 C.F.R. pt. 235). See *supra* Part II.B for a more detailed explanation of the Durbin Amendment.

43. In cash payments the purchaser provides the merchant with cash equal to the amount of purchase price. The risk that the merchant will not get paid does not exist here because goods and services are not exchanged without the full value of the cash unless otherwise agreed upon (under certain circumstances such as contracts or the delivery of goods, payment might not be tendered until after the goods are received). The downside of cash payments for merchants is there is a risk of theft from employees or outsiders. Additionally, the payments are not automatically deposited, so the merchant or merchant's employees have to manually transfer the cash to the merchant's bank.

44. In a check payment, the purchaser provides a check for the amount of the purchase price. After the merchant receives the check, the merchant has to manually transfer the checks to the merchant's banks because the deposit is not automatic. In the past few years there have been improvements in check depositing, such as being able to deposit checks by using the camera on your mobile phone. *See, e.g.*, Press Release, Sun National Bank, Sun National Bank Launches SunMobile Deposit (Oct. 8, 2013), *available at* http://online.wsj.com/article/PR-CO- 20131008-906737.html. This only eliminates the deposit problem and not the risk of adequate funds. Furthermore, check writing is time-consuming and will slow down the checkout process, which may lead to merchants needing to staff more employees. *See* Epstein, *supra* note 4, at 1317.

45. Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,723 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

since merchants have no information about the consumers' financial positions.[46] Additionally, consumers often make larger purchases with debit cards and credit cards than they would with cash.[47]

Checks normally clear "at par," and therefore, the merchant receives the full value of the check without fees.[48] On the other hand, credit and debit cards both have interchange fees, but these higher fees are paid in exchange for greater merchant and consumer benefits, such as convenience and assuring the merchant that there are available funds.[49] Merchants are essentially paying for the option to have more information about the consumers' financial positions, and to avoid making irreversible decisions without having all of the information.[50] Both debit cards and credit cards also eliminate the hassle and risk of having and processing cash or check payments.[51]

A. Debit Card Transactions

Debit card usage has rapidly increased since the mid-1990s and is the fastest-developing form of electronic payment.[52] The Durbin Amendment defines a debit card as "any card, or other payment code or device, issued or approved for use through a payment card network to debit an asset account (regardless of the purpose for which the account is established), whether authorization is based on signature, PIN, or other means."[53]

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46. In check transactions, the merchant assumes the risk that there might not be enough money in the checking account to cover the cost of the purchase. *See* Epstein, *supra* note 4, at 1317. The merchant also has no additional knowledge about the consumer's financial position; therefore, the merchant has less information in these transactions than it does in debit card transactions. *Id.*

47. John, *supra* note 41, at 1.

48. Epstein, *supra* note 4, at 1316. At first glance, it seems like merchants would prefer paying zero fees. However, there are some added risks, one being that the merchant bears the risk that there might not be sufficient funds to cover the cost of the purchase, and another being that the merchant takes this risk without any knowledge of the consumers' financial status. *Id.* at 1316-17.

49. Epstein, *supra* note 22, at 29. Often the fees for credit cards are higher than the debit card fee because the benefits for credit card users are generally greater. *Id.*

50. This is very similar to other option agreements or contracts because merchants are purchasing the option to get more information before making a decision. *See* BLACK'S LAW DICTIONARY 544 (4th pocket ed. 2011) (defining option agreement as "[a] share-transfer restriction that commits the shareholder to sell, but not the corporation or other shareholders to buy, the shareholder's shares at a fixed price when a specified event occurs").

51. *See supra* notes 43-44.

52. Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,723 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

53. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2073 (2010).

Most debit card transactions are processed in the following manner, commonly referred to as the "open-loop" or "four-party" system.[54] The parties in this system are: the consumer; the merchant; the merchant's bank; the debit card network (e.g., Visa or MasterCard); and the entity that issued the debit card to the consumer, that is, the card-issuing bank.[55] When a debit card is swiped, the consumer's identity and bank account information is made available; however, a signature or a personal identification number (PIN) is needed to initiate the transaction.[56] The transaction information is then sent to the merchant's bank.[57] If the transaction is authorized, then the merchant's bank sends the transaction information to a debit-card network.[58] This debit-card network connects the merchant's bank with the consumer's bank.[59] A network is used to relay information through the bank that issued the consumer's debit card.[60] The consumer's bank then verifies that there are sufficient funds and that the card has not been reported lost or stolen.[61] If there is enough money in the consumer's debit account, then notice of a complete transaction is sent to the merchant through the processors, and the purchase is finalized.[62] The consumer's bank then transfers the transaction amount from the consumer's account to the merchant's account; however, the card-issuing bank assesses interchange fees and other processing fees at this point.[63] The bank that issued the consumer's debit card will transfer the funds to the merchant's account at the merchant's bank.[64] The merchant will pay their bank for interchange fees and other processing charges at a later time.[65]

Merchants pay three types of fees: (1) to their bank; (2) to card companies, e.g., Visa and MasterCard; and (3) to the card-issuing

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54. This Note focuses on the four-party, or open-loop system; however, it is important to acknowledge that there is a less commonly used "three-party" or "closed-loop" system. *See* Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81,723, n.6. The three-party system is different because the merchant and consumers contract directly with the network, instead of the network setting the fees. *See* Lisa Farrell, *A Step in the Right Direction: Regulation of Debit Card Interchange Fees in the Durbin Amendment*, 15 LEWIS & CLARK L. REV. 1077, 1082 (2011).

55. Debit Card Interchange Fees and Routing, 75 Fed. Reg. at 81,723.

56. NORTH, *supra* note 22, at 8.

57. *Id.*

58. *Id.*

59. *Id.*

60. *Id.*

61. Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,723 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

62. NORTH, *supra* note 22, at 8.

63. *See id.* The card-issuing bank takes the interchange fee before transmitting to the merchant's bank, so the merchant does not receive the full value of the transaction. *Id.*

64. McGinnis, *supra* note 2, at 288.

65. NORTH, *supra* note 22, at 8.

bank, i.e., the consumer's bank.[66] These fees are often one of the largest portions of merchants' costs of doing business.[67] The Durbin Amendment only regulates the interchange fees to the consumer's card-issuing bank.[68] In an open-loop system, the interchange fees are set by the debit card-issuing bank[69] and are often the largest portion of the fees for each transaction.[70] The debit card-issuing bank and the merchant's bank both receive a portion of the fees.[71]

Under their contractual obligations to networks such as Visa and MasterCard, merchants are not allowed to assess a surcharge on consumers who use debit cards or credit cards instead of other payment methods.[72] The consumer does not directly see the effects of the interchange fees; instead, the fees are incorporated into the price of the goods or services as a cost to the merchant.[73]

B. Debit Card Market

Electronic payment tools such as debit cards and credit cards operate in a two-sided market.[74] A two-sided market occurs during a three-party transaction, when the middle party has an incentive to make sure that the other two sides want to do business together.[75] "[T]he ability to satisfy one side of the market depends on the continued participation of the other."[76] In debit card transactions, card-issuing banks need *both* merchants to accept and consumers to use debit cards in order to stay in business. Merchants will not accept a company's debit card if the fees are too high or if there are no consumers using that company's card. Conversely, consumers will not obtain or use a company's card if few merchants accept it or if the

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66. *Id.*

67. Gregory D. Wasson, the CEO of Walgreens, stated that interchange fees are his company's fourth-largest cost after salaries, mortgages and rent, and healthcare. Epstein, *supra* note 22, at 24.

68. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068 (2010).

69. *See* Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,723 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235); John, *supra* note 41, at 1.

70. Farrell, *supra* note 54, at 1083.

71. *Id.*

72. *Id.* Merchants can increase the cost of their goods or services and therefore spread the cost of these fees among all payment methods.

73. *See id.*

74. *See id.* at 1087.

75. Epstein, *supra* note 4, at 1323. Examples of two-sided market scenarios include the following: (1) Newspapers put a greater-cost burden on advertisers because advertisers will only purchase ads if enough people read the newspaper, so the cost for readers has to be lowered to encourage more readers, Marc Rysman, *The Economics of Two-Sided Markets*, 23 J. ECON. PERSP. 125, 128 (2009); and (2) Groupon tries to match businesses with customers, and typically, the fees are borne by the businesses, Epstein, *supra* note 4, at 1324.

76. Epstein, *supra* note 22, at 26.

fees are too high.[77] Therefore, card-issuing banks have to carefully balance the interests of both parties when setting the amount of fees and when determining who will bear the burden of those fees.[78]

In most two-sided markets, the fees are not shared equally.[79] Typically, the party that is inelastic, i.e., less sensitive to changes in price, will pay a greater portion of the costs.[80] A merchant's demand for consumers is often less sensitive to changes in price than a consumer's demand for the goods and services provided by the merchants.[81] Therefore, merchants are more likely to bear a majority of the costs associated with interchange fees.

C. The Hidden Fee

The debit card interchange fee is similar to a "hidden tax."[82] The card-issuing banks are able to generate revenue with very little detection, because normally, neither the merchant nor the consumer is fully aware of how much these fees cost since they are not billed separately to the merchant but instead are deducted from the amount deposited into the merchant's account.[83] Regulations such as the Durbin Amendment protect merchants from these hidden fees.

The consumer does not directly see the cost of the interchange fees; instead, it is incorporated into the price of the goods or services because it is a cost to the merchant.[84] This is similar to a hidden tax for consumers, because if they are unaware of these fees, their spending and use of the card is not affected by the price of the interchange fee.[85] However, if the listed prices are higher because of this additional merchant cost, then the consumer might be less likely to base a purchase on the sticker shock than if the fee was added on at the register.[86] This is basic supply-and-demand economics: if the price is

77. *See e.g.*, NORTH, *supra* note 22, at 15; McGinnis, *supra* note 2, at 301.

78. *See* Epstein, *supra* note 4, at 1323. For example, online dating services want to have an equal number of men and women, so they charge lower prices to women to attract more of them, because women are less likely to join an online dating service than men. *Id.* at 1324.

79. *Id.*

80. *Id.* The Ramsey pricing principle states that a price should be set so that the price-marginal cost margins are inversely related to the sensitivity of demand to the price; and thus, that more revenue will be recovered from the side with a more inelastic demand. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], POLICY ROUNDTABLES: TWO-SIDED MARKETS 12-13, 25 (2009), *available at* http://www.oecd.org/daf/competition/44445730.pdf.

81. Epstein, *supra* note 22, at 26.

82. *See generally* Brian Galle, *Hidden Taxes*, 87 WASH. U. L. REV. 59 (2009) (explaining that a hidden tax is a tax that goes unnoticed by those who pay them).

83. NORTH, *supra* note 22, at 8; McGinnis, *supra* note 2, at 288.

84. *See* Farrell, *supra* note 54, at 1083.

85. *See* Galle, *supra* note 82, at 75-77.

86. *See* Raj Chetty et al., *Salience and Taxation: Theory and Evidence*, 99 AM. ECON. REV. 1145, 1146 (2009).

higher, fewer consumers will demand the good or service; however, if the consumer is ignorant of the higher price—because it is hidden—then it may not affect the demand.[87]

Since the interchange fees are taken out of the amount deposited into the merchant's bank account, merchants may be unaware of the exact cost of these fees, unless they calculate the fees themselves. The merchants never see a bill with the total cost of the interchange fees.[88] This might explain why the cost savings post-Durbin Amendment may not have been passed along to the consumer.

The hidden nature of the interchange fees is beneficial for the card-issuing banks because they are able to generate revenue without negative effects from either side of the two-sided market. When banks attempt to issue more obvious fees, they often lose consumers to other methods of payment.[89]

IV. EFFECTS ON THE PARTIES

Senator Durbin and other members of Congress saw a problem with the debit card interchange fee, so they enacted the Durbin Amendment to help small businesses.[90] It remains unclear whether the Amendment actually helps small businesses;[91] however, it does affect all three parties—the merchants, the consumers, and the card issuers—in a variety of ways. These effects are interesting because of the nature of the two-sided market; i.e., something that affects one party will also affect one of the other parties.[92] Keeping merchants and consumers in the market, while simultaneously allowing the card issuer to make a profit, is a careful balancing act. This Note will discuss a few of the big issues and then explain the interwoven effects on the parties involved.

A. Cost Savings for Merchants

In an ideal world, merchants would pass their cost savings along to consumers; unfortunately, the real world is more complicated than that. Merchants save over $8 billion per year with the Durbin

87. *See, e.g.*, Galle, *supra* note 82, at 75-77.

88. *See supra* Part III.A.

89. On September 29, 2011, Bank of America and other major banks announced a $5 monthly fee for debit cards, but due to consumer outrage, the banks had to abandon the plan about a month later. NORTH, *supra* note 22, at 9.

90. 156 CONG. REC. S4839 (daily ed. June 10, 2010) (statement of Sen. Richard Durbin).

91. *See e.g.*, McGinnis, *supra* note 2, at 285.

92. *See supra* Part III.B.

Amendment interchange fees.[93] If merchants do not pass these savings along to consumers, then consumers lose on both ends because the banks have to make the lost revenue up by charging additional fees or by cutting services.[94] A decrease in debit card interchange fees would be good for the economy if the savings were passed along to the consumers and if consumer spending increased.

Scholars and analysts disagree on whether the savings are being passed along to consumers. Some say that merchants are holding on to the $8 billion in savings they received from the Durbin Amendment,[95] while others argue that the savings are being passed along to consumers.[96] It is possible that merchants are unaware of their cost savings, which would explain why they have not lowered their prices.[97] There is also a possibility that card issuers will raise the interchange fees on credit cards because they are currently unregulated by the Durbin Amendment.[98] If these fees increase, there may not be any cost savings for merchants to pass along to consumers.[99]

B. Lost Profits on Low-Priced Items

While high-priced items will create cost savings for merchants with regard to the interchange fees, low-priced items will cost merchants more in fees.[100] Merchants that sell items worth less than $20 will actually pay higher interchange fees than they were paying be-

93. Vicki Needham, *Report: Businesses Passing on Swipe Fee Savings to Consumers*, THE HILL (Oct. 1, 2013, 5:16 PM), http://thehill.com/blogs/on-the-money/banking-financial-institutions/325851-report-businesses-passing-on- swipe-fee-savings-to-consumers. This also means that banks are losing $8 billion in revenue. *See infra* Part IV.C.

94. *See infra* Part IV.C.

95. *The Durbin Effect: Two Years Later, Consumers Still Not Benefitting from Durbin Amendment*, ELEC. PAYMENTS COAL., http://wheresmydebitdiscount.com/the-durbin-effect/ (last visited Apr. 6, 2014). This article, however, cites a survey that looks at low-cost items, such as milk, peanut butter, a hammer, and a Slurpee, to illustrate that the cost savings have not been passed along. This is flawed logic because low-priced items have a higher burden with the post-Durbin Amendment interchange fees than they did before the Durbin Amendment.

96. Vicki Needham, *Retailers File Appeal Over Credit Card Swipe Fee Settlement*, THE HILL (Jan. 2, 2014, 6:19PM), http://thehill.com/policy/finance/194318-retailers-file-appeal-over-credit-card (quoting Mallory Duncan, Senior Vice President and General Counsel of the National Retail Federation).

97. *See supra* Part III.C. There are also a lot of other factors that could explain the increase in prices above inflation, such as an increase in other costs or an increase in demand for a good or service.

98. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068 (2010).

99. This also suggests that if fees and costs can be shifted to credit card interchange fees, then the mere regulation of debit card interchange fees is a frivolous task; therefore, it would be beneficial to also regulate the credit card interchange fees, but this idea extends beyond this Note.

100. *See infra* Table 1.

fore the Durbin Amendment.[101] Approximately 20% of all debit card purchases are for low-priced items.[102] These small-ticket sales come from coffee shops, convenience stores, fast food restaurants, and other merchants that sell items or services worth less than $20.

Before the Durbin Amendment, there was special pricing for merchants with low-cost items; however, after the Durbin Amendment, the networks set interchange fees at the maximum amount allowed.[103] Therefore, instead of using the ad valorem interchange fee, the maximum of $0.21, plus fraud prevention, is being charged.[104] As illustrated in Table 1, when the transaction cost is below approximately $20, merchants are actually paying more in interchange fees than they were before the Durbin Amendment.

Table 1:

PRICE OF TRANSACTION	BEFORE DURBIN AMENDMENT	AFTER DURBIN AMENDMENT – FEE CAP	AFTER DURBIN AMENDMENT – FEE CAP PLUS FRAUD PREVENTION	MERCHANT SAVINGS OR (COSTS)
	Interchange fee of 1.15% per transaction [105]	Interchange fee of $0.21 per transaction	Interchange fee of $0.21 per transaction plus 0.05%	Fee Before minus Fee After plus Fraud Prevention
$1	$0.0115	$0.21	$0.2105	($0.119)
$5	$0.0575	$0.21	$0.2125	($0.155)
$10	$0.115	$0.21	$0.215	($0.1)
$20	$0.23	$0.21	$0.22	$0.01
$25	$0.2875	$0.21	$0.2225	$0.065
$38[106]	$0.437	$0.21	$0.229	$0.208
$50	$0.575	$0.21	$0.235	$0.34
$100	$1.15	$0.21	$0.26	$0.89

101. *See id.*

102. Dakin Campbell & Donal Griffin, *Visa, MasterCard Risk "Mom and Pop" Ire with Debit-Fee Increase*, BLOOMBERG (Sept. 23, 2011), http://www.bloomberg.com/news/2011-09-23/visa-mastercard-risk-mom-and-pop-ire-with-debit-fee-increase.html.

103. Sandwith, *supra* note 38, at 241-42.

104. *See e.g.*, *Visa U.S.A. Interchange Reimbursement Fees*, VISA 2-3, 7-8 (Apr. 20, 2013), http://usa.visa.com/download/merchants/visa-usa-interchange-reimbursement-fees-april2013.pdf.

105. NORTH, *supra* note 22, at 6. This is just one example of the average interchange fee. Another source stated the average interchange fee was 1.35%. Epstein, *supra* note 22, at 25.

106. The average purchase price for all debit transactions is $38. NORTH, *supra* note 22, at 12.

PRICE OF TRANSACTION	BEFORE DURBIN AMENDMENT	AFTER DURBIN AMENDMENT – FEE CAP	AFTER DURBIN AMENDMENT – FEE CAP PLUS FRAUD PREVENTION	MERCHANT SAVINGS OR (COSTS)
$250	$2.875	$0.21	$0.335	$2.54
$500	$5.75	$0.21	$0.46	$5.29

Companies like Redbox and Starbucks that sell low-priced items have had to raise prices to cover the increase in debit interchange fees for their products and services.[107] Redbox states the following on its website regarding its increase in prices: "The increase is a result of rising operational costs, including increased debit card fees."[108] Redbox raised the daily rental price from $1 to $1.20 because of the increased fees. Redbox is also an interesting example because its business plan requires the use of a debit or credit card for all purchases, so it cannot offset the increased costs by setting a minimum transaction price or by switching to other payment methods. Instead, Redbox has to pass the costs along to its consumers.[109] Businesses such as coffee shops, dollar stores, and convenience stores could offset some of the higher fees by utilizing the minimum-purchase-price-per-transaction.

Merchants can now require a minimum purchase before allowing a consumer to use a credit card or debit card.[110] Before the Dodd-Frank Act, merchants would have been penalized for such requirements.[111] Ideally, this would allow merchants to offset some of the added costs of accepting debit cards for low-cost purchases. However, merchants do not want to discourage consumers from making purchases, so merchants have little choice but to accept debit cards in order to remain competitive.[112] This forces merchants to pay the fees, especially with respect to companies with products and services worth less than $20.[113] Companies, such as Redbox, with business models that require the use of a debit card or credit card, and without the ability to use a minimum purchase price to offset the higher interchange fees, cannot easily offset the added costs without raising prices.

107. *General Questions: Price Change*, REDBOX, http://www.redbox.com/pricechange (last visited Apr. 6, 2014). There is speculation that Starbucks increased the price of some of its items due to the increased interchange fees. *See* Willy Staley, *Starbucks Price Hike: Could Debit Interchange Be the Culprit?*, MY BANK TRACKER (Jan. 9, 2012), http://www.mybanktracker.com/news/2012/01/09/why-did-starbucks-raise-price/.

108. *General Questions: Price Change*, REDBOX, http://www.redbox.com/pricechange (last visited Apr. 6, 2014).

109. *Id.*

110. NORTH, *supra* note 22, at 12.

111. *Id.*

112. Epstein, *supra* note 4, at 1319.

113. *Id.*

C. Decrease Revenue Generation for the Banks

The Federal Reserve estimates that banks will lose around $8 billion annually due to the current interchange fees, assuming there is no change in debit card usage.[114] This is approximately half of the roughly $16 billion that banks made in 2009.[115] Card-issuing banks will want to make up for the lost revenue in other ways. Not only are the banks making less in interchange fees than they made in previous years, but these fees may not fully cover the cost per transaction, because the Federal Reserve used a narrow definition of which costs to consider when determining the cap.[116]

Card issuers can make up for their lost revenue by: (1) adding fees in other places, (2) cutting back on rewards programs, (3) imposing an annual fee, (4) raising other fees, or (5) lowering interest rates on deposits.[117] However, the card issuers have to be careful with how they generate this revenue because they do not want to upset the careful balance of this two-sided market.[118]

Card issuers will have a more difficult time imposing other non-hidden fees.[119] For example, on September 29, 2011, Bank of America announced a $5 monthly fee for debit cards, but due to consumer outrage, it had to abandon the plan approximately one month later.[120] This more obvious fee was a problem for the card-issuing banks because consumers became aware of the fees. Assuming that cost savings after the final ruling on the Durbin Amendment are passed along to consumers, the overall cost to the consumer would probably be roughly equal to either: (1) obvious fees, i.e., monthly fees, or (2) the higher interchange fees. However, the effect on a consumer's decisionmaking is greater when the fees are more obvious.[121]

Increased fees and decreased services make consumers worse off than they were before the Durbin Amendment; however, for the banks, this set-back only means that they will have to find a less obvious and more straight-forward way to recoup their revenue.[122]

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114. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,397 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235); Needham, *supra* note 93.

115. *See* Debit Card Interchange Fees and Routing, 76 Fed. Reg. at 43,397.

116. *See* John, *supra* note 41, at 1.

117. *Id.* at 2.

118. *See supra* Part III.B.

119. *See supra* Part III.C.

120. NORTH, *supra* note 22, at 9.

121. *See supra* Part III.C.

122. See NORTH, *supra* note 22, at 10, for a chart of the mitigation strategies for the top ten bank-holding companies; also see *id.* app. at 17-18, for what these companies have told their investors.

D. Effect on Exempted Banks

The Durbin Amendment does not apply to any issuer that has assets below $10 billion;[123] meaning these small issuers will not have to subscribe to the Board's regulations of debit card interchange transaction fees.

Small banks, though technically exempted from the Durbin Amendment, might also have a decrease in revenue generation due to the Durbin Amendment.[124] Smaller banks have to spread their costs over fewer transactions, and therefore, they generally have to charge higher fees to recoup their costs.[125] If the market—influenced by the Durbin Amendment—forces smaller, exempt banks to charge lower fees to remain competitive with the non-exempt banks, they might be forced out of the market.[126]

On the surface, the exemption appears to be good for smaller banks because they can charge higher fees.[127] However, the real question is whether these banks can afford to be exempt and charge above the cap. The cap on the Durbin Amendment interchange fees artificially lowers those fees below the competitive market-price. The smaller banks argue there is a risk that merchants will not accept their cards if the interchange fees are higher,[128] and that the consumer would not want a card that was not accepted by merchants because it is a two-sided market.

The exempt banks have two choices: (1) lower their interchange fees and attempt to make the revenue up elsewhere; or (2) drop out of the market. With fewer players in the market, there is a greater monopoly-like effect.

E. Use of Other Methods of Payment

When banks are attempting to generate revenue in other manners, consumers might want to switch to other methods of payment, such as credit cards or cash.[129] Banks will want to encourage and incentivize consumers to use services that generate the most revenue. Thus, if banks decide that the profit margin is not large enough for debit cards, they may encourage consumers to switch to other methods of payment.

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123. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2070 (2010).

124. Sandwith, *supra* note 38, at 224 (arguing that the exemption might not be effective and instead suggesting a two-tiered system).

125. John, *supra* note 41, at 1.

126. *Id.* at 2.

127. *Id.* at 1.

128. *Id.* at 2.

129. *Id.*

The interchange fees for credit cards are currently unregulated; therefore, banks can generate more revenue on swipe fees, as well as interest on late payments, without charging consumers for the use of a credit card.[130] This might, however, create potential for abuse of the credit card swipe fees, which might eventually require congressional regulation.

It is beneficial to encourage people to only spend the money they have rather than borrowing from credit card companies, especially when the economy is rocky. These spending habits can help avoid the accrual of debt and subjection to high interest rates. A debit card is the ideal method of payment for consumers with self-control problems.[131] Debit cards make it easier for consumers to manage their finances and avoid the dangerous possibility of over-spending that comes with credit card use.[132] However, if the fees for debit cards are too high, consumers will use other methods of payment.[133]

V. SOLUTIONS

Senator Durbin and other members of Congress saw a problem with the debit card interchange fees.[134] This Note considers whether the Durbin Amendment's intended solution was optimal. To assess this, there are five alternative options to consider: (1) leave the Durbin Amendment "as is;" (2) repeal the Durbin Amendment and return to a pre-amendment climate with no regulation; (3) have no interchange fee; (4) change the amendment to act as a cap on the percentage of the sale; and (5) change the amendment to cap the percentage of the sale price while capping the total interchange fee.

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130. When the economy is bad, banks may prefer debit cards because the consumers cannot default on debit card payments. This brings up another informational asymmetry problem: banks want bad consumers, who may default on payments or spend more than they can afford, to use debit cards. However, banks want good consumers to use credit cards if banks can make more money from credit cards.

131. See Manuel A. Utset, *The Temporally Extended Family & Self-Control: An Essay for Lee E. Teitelbaum*, 2006 UTAH L. REV. 107, for a discussion on self-control as it relates to family law.

132. John, *supra* note 41, at 2.

133. *See* TOTAL SYS. SERVS., INC., 2011 CONSUMER DEBIT RESEARCH: FINAL REPORT OF SURVEY AND FOCUS GROUP RESULTS (2011), *available at* http://www.tsys.com/Downloads/upload/2011_TSYS_Mercator_DebitResearch _Final_2.pdf; Gail Cunningham, *Overwhelming Majority of Consumers Would Change Financial Institutions to Avoid Paying Debit Card Fee*, NAT'L FOUND. FOR CRED. COUNS. (Nov. 1, 2011), http://financialeducation.nfcc.org/2011/11/01/overwhelming-majority-of-consumers-would-change-financial-institutions-to-avoid-paying-debit-card-fee/.

134. *See* 156 CONG. REC. S4839 (daily ed. June 10, 2010) (statement of Sen. Richard Durbin).

A. Leave the Durbin Amendment "As Is"—Cap on the Total Fee

The first option is simple: leave the Durbin Amendment as enacted.[135] The final adopted rule provides that the interchange fees charged cannot exceed the $0.21, plus five basis points of the transaction's value as a fraud prevention adjustment.[136]

The costs and benefits of the Durbin Amendment, as it currently reads, have been discussed throughout this Note.[137] The Durbin Amendment creates overall cost savings for merchants that may or may not be passed along to the consumers.[138] These savings are taken from the revenue of the card-issuing banks.[139] The banks make up the lost revenue by reducing services or by charging other fees.[140] Additionally, merchants with low-priced items would have increased costs because the interchange fees would not be proportional to the transaction price.[141]

The expense of processing each transaction is the same, regardless of the monetary value. If the cap on interchange fees is set properly, then this method can accurately reflect the cost per transaction.[142] However, even assuming a cap on the interchange fees may accurately represent the actual cost per transaction, it does not meet the Durbin Amendment's stated goal: to create a "reasonable and proportional" interchange fee.[143] Better interchange fees would spread these costs out more fairly based on the price of the transaction.[144]

B. Repeal the Durbin Amendment—No Caps

Under the next option, there would be no regulation of the debit card interchange fees, and the debit card interchange fees would return to pre-amendment status. This option ignores any problem that was present, or assumes there was none, before the Durbin Amendment.

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135. See *supra* Part II.B for a more thorough explanation of the Durbin Amendment.

136. Debit Card Interchange Fees and Routing, 76 Fed. Reg. 43,394, 43,404 (July 20, 2011) (to be codified at 12 C.F.R. pt. 235).

137. *See supra* Part IV.

138. *See supra* Part IV.A.

139. *See supra* Part IV.C.

140. *See supra* Part IV.C.

141. *See supra* Part IV.B.

142. *See supra* Part III.A (discussing how a debit card transaction works, which illustrates that the dollar value of the transaction is irrelevant to the cost to the parties).

143. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068 (2010).

144. See *infra* Part V.E for a discussion of a suggested interchange fee that is both reasonable and proportional.

Without regulation, the market would set and determine the percentage of the fees, and larger corporations would get volume discounts. One could definitely argue that this area does not need regulation.[145] Sometimes the best solution is no solution, because the powers of the market will come to the most equitable solution. However, due to the "big two" controlling the market—Visa and MasterCard—the debit card market faces a potential problem for antitrust issues. The big two likely will not set the interchange fees at the most equitable point, because there is little, if any, competition in the market to balance their interests.

Another concern regarding a climate without regulation is that, due to this fee's hidden nature, it has the potential for abuse by the card-issuing bank. Since merchants, and especially consumers, are not easily apprised of the exact amount of fees, they might be less sensitive to a change in the price of interchange fees, and the fees could rise in increments small enough to go unnoticed. Also, merchants are relatively price inelastic because they want to accept debit cards for the ease and convenience provided to their customers.

C. No Interchange Fee

Another option would be to prohibit interchange fees. Under this option, debit cards would be similar to checks, which clear "at par."[146] Some scholars suggest that all debit interchange fees should be abolished.[147] These transactions could instead clear at par, like checks;[148] however, debit cards provide multiple additional features that checks do not. First, with a check, a merchant has no added knowledge about a consumer's financial position and bears the risk that there might not be enough money in the checking account to cover the cost of the purchase.[149] Therefore, a merchant has less information in a check transaction than it does in a debit card transaction.[150] Second, depositing a check is not automatic, and merchants have to manually

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145. Scholars, such as Milton Friedman, might argue that a free market is the best solution to many economic problems, and that unregulated trade and business is far better than any artificial regulations the government can create. *See e.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM: FORTIETH ANNIVERSARY EDITION 182 (2002); MILTON FRIEDMAN & ROSE FRIEDMAN, FREE TO CHOOSE: A PERSONAL STATEMENT (1990).

146. The merchant would receive the full value of the check without fees. Epstein, *supra* note 4, at 1316. However, this ignores the fact that debit cards offer advantages of convenience, as well as assuring the merchant that there are available funds. Epstein, *supra* note 22, at 29.

147. Epstein, *supra* note 4, at 1322.

148. *Id.*; *see also id.* at 1322-24 (explaining why Georgetown University Law Center Professor, Steven Salop's, argument to abolish all debit interchange fees so the transactions clear at par is faulty).

149. *Id.* at 1317. Consumers will also pay an additional fee if their checks bounce.

150. *Id.*

transfer the checks to their own banks. Debit card transactions automatically place funds in a merchant's bank. Third, check writing is time-consuming and slows down the checkout process, which might require merchants to staff more employees.[151]

A bigger problem with this option is that it only amplifies the revenue problem for debit card-issuing banks. These banks would either move away from offering debit cards as a payment option, or they would make up the lost revenue in other ways. Although debit cards are similar to checks in some regards, they provide more benefits than checks, and these services need to be funded in some way.

D. Cap the Percentage of the Transaction[152]

Another alternative to the current Durbin Amendment is to place a cap on the percentage of the transaction price when calculating interchange fees, instead of capping the total fees allowed. This cap could be used to artificially simulate a truly competitive market. Also, this option would likely differ from the option to eliminate the Durbin Amendment only in the sense that the percentage of the transaction price would likely be lower, because the current market is not truly competitive.[153]

Using a percentage of the transaction's interchange fees does achieve the Durbin Amendment's goal of proportionality. However, as shown in Figure 1, calculating the interchange fee as a percentage of the transaction price[154] grows without bounds. Therefore, it does not meet the Durbin Amendment's stated goal of creating a reasonable interchange fee.[155] For higher-priced items, the interchange fees do not accurately represent the costs to the card-issuing bank for the transaction.

E. Double Cap: Cap Percentage of the Transaction Price and Total Interchange Fee

The final option—a double cap on interchange fees—is optimal. This option suggests adjusting the current Durbin Amendment to more closely match the goal of being "reasonable and proportional." The proposed adjustment would cap the ad valorem percent-

151. *Id.* Not surprisingly, use of checks has decreased since the mid-1990s. Debit Card Interchange Fees and Routing, 75 Fed. Reg. 81,722, 81,723 (proposed Dec. 28, 2010) (to be codified at 12 C.F.R. pt. 235).

152. This Note recommends this option as the second-best option.

153. *See supra* Part III.B.

154. The Before Amendment line is an interchange fee based on the percentage of the transaction price.

155. Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068 (2010).

age,[156] while capping the total value of the interchange fees.[157] The total cap should be higher than the current $0.21, and the cap on the percentage should be slightly lower than the percentages set by the free market.[158]

For example, the regulation could state that there is a 1% interchange fee, with a cap of $0.50 per transaction.[159] As shown in Table 2 and Figure 1 below, the interchange fee under the hypothetical double-cap system is lower than the pre-Durbin Amendment fee, regardless of the transaction cost, because the percentage has been lowered. The hypothetical double-cap system has lower interchange fees than the Durbin Amendment fees at both low and high transaction costs, using mid-range charges to compensate for the lost revenue.

Table 2:

PRICE OF TRANSACTION	BEFORE DURBIN AMENDMENT	AFTER DURBIN AMENDMENT – FEE CAP PLUS FRAUD PREVENTION	HYPOTHETICAL FEE WITH TOTAL CAP AND PERCENTAGE CAP
	Interchange fee of 1.15% per transaction [160]	Interchange fee of $0.21 per transaction plus 0.05%	Hypothetical interchange fee of 1% with cap of $0.50
$1	$0.0115	$0.2105	$0.01
$5	$0.0575	$0.2125	$0.05
$10	$0.115	$0.215	$0.10
$15	$0.1725	$0.2175	$0.15
$20	$0.23	$0.22	$0.20
$25	$0.2875	$0.2225	$0.25
$38[161]	$0.437	$0.229	$0.38

156. This is to create a more *proportional* interchange fee.

157. This is to create a more *reasonable* interchange fee that reflects the true cost per transaction.

158. This can be seen *infra* Figure 1 by the less steep slope of the percentage. The graph also shows that the interchange fee will always be smaller than before the Durbin Amendment.

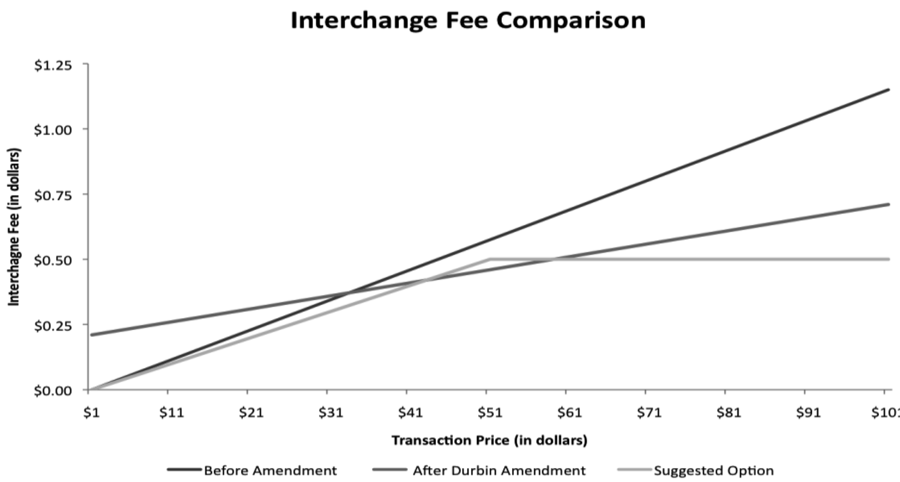
159. There is no specific math or empirical study to support these numbers. They were selected because the percentage of 1% is slightly below the 1.5% the free market set and the cap was higher than the $0.21 cap set by the current Durbin Amendment. It is likely that the true cost per transaction is lower than $0.50 but as explained *infra* Part V.E, the cap on the total should be set higher than the exact cost per transaction in order to offset the transactions where the interchange fee falls below the cost per transaction.

160. This is just one example of the average interchange fee. NORTH, *supra* note 22, at 12. Another source stated that the average interchange fee was 1.35%. Epstein, *supra* note 22, at 25.

161. The average purchase price for all debit transactions is $38. NORTH, *supra* note 22, at 12.

PRICE OF TRANSACTION	BEFORE DURBIN AMENDMENT	AFTER DURBIN AMENDMENT – FEE CAP PLUS FRAUD PREVENTION	HYPOTHETICAL FEE WITH TOTAL CAP AND PERCENTAGE CAP
$50	$0.575	$0.235	$0.50
$100	$1.15	$0.26	$0.50
$250	$2.875	$0.335	$0.50
$500	$5.75	$0.46	$0.50

Figure 1: Comparison of Three Different Options for the Interchange Fee[162]



The cap on the total amount of interchange fees is designed to reflect the fact that the cost per transaction is the same, regardless of the transaction's monetary value. The cap that can be charged should take into account more costs than the current cap does.[163] The current formula does not include using fixed costs to implement and maintain the process for debit card transactions, and it also excludes large, non-electronic variable costs, such as customer service, billing, and advertising.[164] The cap on the total amount of interchange fees should also be set higher than the exact cost per transaction, so as to offset those transactions with interchange fees below the cost per

162. This graph is a visual aid that demonstrates the differences between the interchange fees both before and after the Durbin Amendment, and one possible suggestion using the percentage-cap and total-cap option. As noted *supra* note 161, there is no specific math or empirical study used to support the suggested interchange fees. The graph is included merely to illustrate the properties of the double-cap approach.

163. The cap should be higher than the $0.21 under the Durbin Amendment because it takes more costs into consideration.

164. Epstein, *supra* note 22, at 26.

transaction. In order to prevent the banks from withholding debit cards because they do not make any profit, the caps should be set slightly higher than the actual costs per transaction.[165]

The cap on the percentage will likely be slightly lower than the percentages set by the free market.[166] This "free" market is not truly free, because of the few power players that control the market, such as MasterCard and Visa. The goal of a lower percentage is to more fairly represent what the percentage would be under a free market. However, it is possible that a regulation with the same, or slightly higher, percentage would accomplish the same double-cap goals as a proportional fee for lower-cost items, and a reasonable fee for higher-priced items. This should be discussed in the rulemaking process.

A potential problem with this solution is that the debit card-issuing banks would still have a slight issue generating revenue, because the interchange fees on low-priced items would not cover the cost per transaction and would lose some of the fees that were above the cost per transaction.[167] One solution to this problem is to set the cap on the total above-the-average cost to account for the lower-priced items.

Some might argue this imputes a windfall of fees on lower-priced items, but allowing this windfall might be better than creating a burden on these lower-priced transactions. The cost of these lower-priced items has a greater effect on consumers with moderate-to-low incomes.[168] The goal of this solution is to reallocate the burden more *proportionally*. This would eliminate the current problem of merchants that sell low-priced items, such as Redbox, coffee shops, and convenience stores, placing a disproportionate burden on their profit margins.

Another problem with this solution is that it does not solve the small-bank-exemption problem. Any restriction placed on the interchange fees that lowers them will place additional pressure on the smaller banks. This pressure might force some of these banks out of the market, or it might force them to use other methods to generate revenue. Some small banks might still want to offer debit card services, even if they are generating little or no revenue on that service, because they would not want to lose customers. Even assuming there are no regulations on debit card interchange fees, larger banks might

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165. See *supra* Part III.B for a discussion of two-sided markets.

166. This is shown *supra* Figure 1 by the flatter slope of the percentage. The graph also shows that the interchange fee would always be smaller than it would have been before the Durbin Amendment.

167. Under the example given in the first paragraph *supra* Part V.E, a transaction of $1 would have an interchange fee of one cent, which is likely not enough to cover the transaction costs.

168. John, *supra* note 41, at 2.

pressure the smaller banks out of the market, because a larger bank's ability to spread its fixed costs over more transactions will always result in lower costs per transaction.

This option could also continue the fraud-prevention incentive.[169] However, this Note suggests altering that incentive to increase the cap by a certain amount, accurately reflecting the added cost per transactions. This incentive likely would not affect lower-priced transactions. If the fraud-prevention measures are variable costs and not fixed costs, then the increase in the cap might need to be an amount greater than the cost per transaction in order to compensate for the number of transactions below the cap.

Under this double-cap scheme, it would not be necessary to allow merchants to set minimum-purchase prices for consumers to use credit cards or debit cards, because the fee would return to a percentage of the purchase price, just like it did before the Durbin Amendment.

Merchants and consumers stand to benefit from this because, under that scheme, merchants would be more willing to accept any method of payment from consumers. For example, merchants that sell furniture, a high-priced item, would have a $0.50 interchange fee, which would not noticeably cut into their profit margins. Consumers also stand to benefit because they could use their cards for smaller purchases without having to meet some threshold. For example, merchants that sell something for $1, a low-priced item, would only be charged $0.01, which is a small proportion of the price.[170]

A double cap on the interchange fees is the optimal alternative because it eliminates disproportionate interchange fees on low-priced items while lowering the excessive interchange fees on high-priced items. Placing a double-cap on the interchange fees would result in a reasonable *and* proportional fee.

VI. CONCLUSION

Senator Durbin and other members of Congress saw a problem with the debit card interchange fees, so they recommended an additional provision to the Dodd-Frank Act, seeking to "help small businesses, merchants, and consumers by providing relief from high interchange fees for debit card transactions."[171] The Durbin Amend-

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169. *See* Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. No. 111-203, § 1075, 124 Stat. 1376, 2068 (2010); *supra* Part II.B.3.

170. Contrast this with an interchange fee of $0.21, which is 21% of a merchant's potential revenue. A merchant's revenue will decrease by 21% before even considering the merchant's operating costs.

171. 156 CONG. REC. S3695 (daily ed. May 13, 2010) (statement of Sen. Richard Durbin); *see also* 156 CONG. REC. S4839 (daily ed. June 10, 2010) (statement of Sen. Richard Durbin).

ment attempts to protect consumers and merchants from hidden interchange fees.

This Note does not suggest changing the goals of the Durbin Amendment, but instead, it suggests altering the Board's final regulation. The optimal regulation would more closely match the Durbin Amendment's goal of reasonableness and proportionality while considering the card issuer's cost per transaction. This Note suggests placing a double cap on interchange fees, which would be *reasonable* because it regulates the entire chargeable amount and *proportional* because it is based on a stated percentage of the purchase price.