Banking and Finance Law Daily Wrap Up, CREDIT, DEBIT AND GIFT CARDS—E.D. Ky.: Fed debit card interchange fee rule upheld against Linney's Pizza challenge, (Sept. 16, 2025)

Banking and Finance Law Daily Wrap Up

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The district court rejected claims that Regulation II unlawfully inflated fees, finding that the Fed acted within statutory authority and reasoned decision making.

The U.S. District Court for the Eastern District of Kentucky upheld the Federal Reserve's Regulation II, which sets debit card interchange fee standards under the Durbin Amendment of the Dodd-Frank Act. The court granted summary judgment to the Fed and denied summary judgment to Linney's Pizza, finding that the rule's inclusion of fixed processing, transaction-monitoring, fraud-loss, and network fee costs did not exceed statutory authority and that the Fed's decision to adopt a uniform fee cap reflected reasoned decision making rather than arbitrary or capricious action (*Linney's Pizza, LLC v. Board of Governors of the Federal Reserve System*, No. 3:22-cv-00071 (E.D. Ky. Sept. 15, 2025)).

Statutory and regulatory background. Debit card transactions involve four parties: the consumer, the issuing bank, the acquiring bank, and the payment card network. Each transaction proceeds through authorization, clearance, and settlement. Issuers charge acquirers interchange fees to compensate for their role, while networks charge processing fees and acquirers charge merchant discount fees. These costs are ultimately borne by merchants and consumers. Prior to the Dodd-Frank Act, interchange fees averaged 44 cents per transaction, while costs ranged between 8 and 13 cents.

Congress enacted the Durbin Amendment in 2010 to require that interchange fees be "reasonable and proportional" to issuer costs. The statute directs the Fed to consider similarities to checking transactions, to distinguish between incremental authorization, clearance, and settlement costs and costs not specific to particular transactions, and to allow adjustments for fraud-prevention expenses.

The Fed initially proposed alternative rules in 2010 with caps ranging between 7 and 12 cents per transaction. After receiving thousands of comments, it issued a final rule in 2011 that capped fees at 21 cents per transaction plus 0.05 percent of the transaction value, with a possible fraud-prevention adjustment.

Prior litigation and supreme court guidance. Regulation II was previously challenged in *NACS v. Board of Governors of the Federal Reserve System*, No. 11-02075 (RJL) (D.D.C. July 31, 2013). The district court vacated the rule, but the D.C. Circuit reversed, finding the statute ambiguous and the Fed's interpretation reasonable. The court remanded for further explanation of transaction-monitoring costs, which the Fed provided in 2015. Linney's Pizza filed suit in 2022 alleging that Regulation II unlawfully inflated interchange fees. The district court initially dismissed the complaint as untimely under the Administrative Procedure Act's six-year statute of limitations. The Supreme Court's 2024 decision in *Corner Post, Inc. v. Board of Governors,* No. 22-1008 (U.S. July 1, 2024)). clarified that an APA claim accrues when the plaintiff is injured by the final agency action. Based on that holding, the case was reinstated.

Claims by Linney's Pizza. Linney's Pizza argued that Regulation II created a third category of costs not authorized by statute, included prohibited costs in the fee standard, and adopted a uniform cap instead of issuer-specific and transaction-specific fees. The company also argued that the rule was arbitrary and capricious because it failed to account for functional similarities between debit card and checking transactions, relied on hypothetical and prohibited costs, and set a universal cap without adequate justification.

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Court's analysis. The court rejected Linney's Pizza's argument that the case implicated the major questions doctrine. It reasoned that debit card fee regulation was directly authorized by the Durbin Amendment, which instructed the Fed to promulgate interchange fee standards. The court emphasized that this was not an unheralded expansion of agency power but a direct implementation of a statute in an area traditionally regulated by the Fed. On the statutory distinction between permissible and impermissible costs, the court held that the Fed's interpretation was reasonable. The statute required certain costs to be included and others to be excluded but left a gray area for costs not explicitly addressed. The Fed acted within its authority by including certain costs in that third category when they were necessary to achieve a reasonable and proportional fee standard.

Treatment of specific cost categories. The court found that fixed authorization, clearance, and settlement costs were properly included because no electronic debit transaction could occur without them, making them transaction-specific. Transaction-monitoring costs were also valid because they occur during authorization and are tied to each transaction, not solely to fraud-prevention efforts. The inclusion of fraud losses was upheld on the basis that such losses arise from settlement of particular transactions, while the separate fraud-prevention adjustment covers measures to prevent fraud before it occurs. Network processing fees were deemed permissible because they are specific to each transaction and necessary for authorization, clearance, and settlement.

Uniform fee standard. Linney's Pizza argued that the statute required issuer-specific and transaction-specific fee caps. The Fed countered that costs cannot be known at the time of authorization, making such an approach impracticable. The court agreed, holding that a representative issuer standard was consistent with statutory language and necessary to implement the requirement that fees be reasonable and proportional.

Arbitrary and capricious review. The court also rejected Linney's Pizza's claim that Regulation II was arbitrary and capricious. The Fed had adequately explained its reasoning, compared debit card processing with check processing, and drawn clear lines between permissible transaction-specific costs and impermissible overhead or general program costs. The court found the Fed's decisions were the product of reasoned decisionmaking within statutory limits.

The case is No. 3:22-cv-00071-GFVT.

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Companies: Linney's Pizza, LLC

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