



## Payment Systems Advisory ■

**AUGUST 22, 2013**

### Federal Reserve to Appeal Ruling Vacating Key Provisions of Regulation II<sup>1</sup>

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On August 21, 2013, Judge Richard J. Leon of the U.S. District Court for the D.C. Circuit held a second status hearing regarding *NACS v. Board of Governors of the Federal Reserve System (NACS v. Board)*.<sup>2</sup> At that status hearing, counsel for the Board of Governors of the Federal Reserve System (“Board”) advised the district court that the Board was filing an immediate appeal of the decision to the D.C. Circuit Court of Appeals. The Board and the plaintiffs will jointly seek an expedited appeal and will request that the court of appeals stay the district court’s ruling during the pendency of that appeal. Both the Board and the plaintiffs advocated against obligating the Board to issue interim regulations during the appeals process. The district court scheduled a third status conference for August 28, 2013, and requested that the parties brief the court on (i) the utility of interim rulemaking during the appeal process and (ii) the practical consequences of lifting the stay of vacatur of key provisions of Regulation II without interim rules in place.

In its memorandum opinion in *NACS v. Board*, released July 31, 2013, the district court held that the Board “clearly disregarded” the intent of Congress in developing the interchange fee limitations and network exclusivity requirements set forth in Regulation II, Debit Card Interchange Fees and Routing (“Regulation II”),<sup>3</sup> but issued a temporary stay of the vacatur and scheduled a status conference for August 14, 2013, to discuss the Board’s position with respect to issuance of replacement regulations and whether the Board intended to appeal the district court decision. At the August 14 hearing, the Board’s counsel reported that the Board had not yet made a determination with respect to these issues. The district court then ordered Board’s general counsel, Scott Alvarez, to appear at a follow-up hearing on August 21 to present the Board’s position on these issues.

At yesterday’s hearing, Mr. Alvarez informed the district court that the Board would be filing an appeal to the Court of Appeals for the D.C. Circuit that same day, along with a request for a stay of the district court’s order pending resolution of the appeal. Mr. Alvarez also indicated that the Board was working with the plaintiffs to request from the court of appeals an expedited appeals process. When Judge Leon reminded counsel that requests for expedited appeal are rarely granted, Mr. Alvarez replied that, since both parties were in favor of expedited appeal and desired

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1 This advisory supplements our advisory regarding the court’s memorandum opinion, available at <http://www.alston.com/advisories/NACS-v-Board>, and our August 14, 2013, update, available at <http://www.alston.com/advisories/update-DC-district-court/>.

2 *NACS v. Bd. of Governors of the Fed’l Res. Sys.*, No. 11-02075, Mem. Op. Jul. 31, 2013.

3 12 C.F.R. part 235.

to keep the stay in place, they believed they could make a compelling argument in support of the request. Judge Leon then inquired about the length of time it would take the Board to craft and implement an interim rule to replace the provisions of Regulation II the district court found defective, and was advised that the Board would first have to study the issue, craft a proposal and publish it for comment. Mr. Alvarez stated that it was possible, in theory, to issue an interim rule, but this would be an extremely lengthy process given the breadth of Judge Leon's ruling. When asked by Judge Leon what interchange rule would be in place if neither he nor the appeals court stayed the vacatur of key provisions of Regulation II during the appeals process, Mr. Alvarez indicated that he believed that no rule would be in place, which would raise the possibility that interchange fees would revert to pre-2011 rates.

Counsel for NACS then spoke and echoed the Board's position that the plaintiffs would prefer the district court to continue the stay pending the appeal and not compel the Board to issue an interim rule. Although NACS suggested that it believed the Board could issue an interim rule, on an emergency basis, in a faster timeframe than the Board had suggested, it also agreed that such an effort would be counterproductive during the pendency of an appeal. NACS's counsel also urged Judge Leon to not make the NACS "a victim of its own success" by creating a situation in which no rule was in place and merchants could potentially be damaged by increases in interchange rates to previously unregulated levels. Judge Leon seized on this statement to make the point that staying the vacatur of the current Regulation II interchange fee limitation during the pendency of an appeal would translate into millions of dollars in potentially unnecessary interchange fees being paid by merchants.

The Board addressed the court once more to state that it does not believe that Judge Leon has the authority to compel the Board to undertake interim rulemaking. The Board also reiterated that both parties would benefit from continuation of the stay of vacatur pending resolution of the appeal, as it is very expensive for both banks and merchants to continually "readjust the debit card system back-and-forth" with new interchange rules.

Judge Leon said that he would await a copy of the Board's motion to appeal. He then ruled that his stay would remain in place for one more week, and that briefs from both parties are due on August 28, addressing (i) the utility of the Board engaging in an interim rulemaking process pending appeal; and (ii) the consequence of lifting the stay of vacatur of Regulation II, specifically whether lifting the stay would result in the payment card networks "operat[ing] like the wild west." Judge Leon concluded the hearing by saying that he was inclined not to grant the stay pending appeal, but that he would "keep an open mind," and that he was surprised that NACS was siding with the Board in favoring a stay pending appeal and disfavoring the issuance of interim rules.

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