



COURT FINDS CALIFORNIA SURCHARGE PROHIBITION UNCONSTITUTIONAL

The United States District Court for the Eastern District of California recently held California Civil Code Section 1748.1 to be an unconstitutional restriction on freedom of speech and void for vagueness. *Italian Colors Restaurant v. Harris*, 2015 WL 1405507 (E.D. Cal. Mar. 26, 2015).

Italian Colors involved a challenge filed against the California Attorney General by five California businesses — a restaurant, gas station, dry cleaners, transmission repair business and web design company — to California Civil Code Section 1748.1 on constitutional grounds. Section 1748.1(a) provides that no retailer in any sales, service, or lease transaction with a consumer may impose a surcharge on a cardholder who elects to use a credit card in lieu of payment by cash, check, or similar means. It also provides that a retailer may, however, offer discounts for the purpose of inducing payment by cash, check, or other means not involving the use of a credit card, provided that the discount is offered to all prospective buyers. Section 1748.1(b) provides for recovery of damages, and attorneys' fees and costs, for violations.

Section 1748.1(e) sets forth the intent of the Legislature, which was to promote the effective operation of the free market and protect consumers from deceptive price increases for goods and services by prohibiting credit card surcharges and encouraging the availability of discounts by those retailers who wish to offer a lower price for goods and services purchased by some form of payment other than credit card. Section 1748.1(f) provides an exemption for charges for payment by credit card that are made by an electrical, gas, or water corporation and approved by the Public Utilities Commission.

The plaintiffs alleged that Section 1748.1 is an unlawful restriction on commercial speech in violation of the First Amendment because it regulates how retailers can describe the price differential between cash and credit purchases. For example, permitting a \$2 discount for cash payment on a \$102 product, but not permitting a \$2 surcharge for payment by credit on a \$100 product, despite the mathematical equivalency. Retailers, the court noted, would prefer to emphasize the latter pricing because behavioral economics research shows that a potential economic penalty is more likely to motivate a change in behavior than a potential economic benefit. Thus, the most effective way to encourage customers to switch from credit

cards to cash is to emphasize the penalty associated with credit card use. Retailers, the court again noted, wish to discourage credit card use because the retailer is charged a so-called "swipe fee" when customers pay with a credit card. Swipe fees can be one of the plaintiffs' largest non-payroll-related expenses.

In examining the plaintiffs' First Amendment argument, the court first looked to whether the First Amendment applies, *i.e.*, whether the statute regulates speech. The court rejected the Attorney General's argument that because only economic activity (adding a "surprise" surcharge at the register) is prohibited by the statute, that no speech is implicated. The court concluded that Section 1748.1 is not an economic regulation that controls what is charged or paid for something. Instead, the court found, the statute regulates speech that conveys price information, which is protected by the First Amendment. What is regulated, the court said, is how the prices are conveyed to customers, not the prices themselves.

Additionally, the court found that the statute (i) singles out a specific class of speakers (*i.e.*, those other than government speakers who are exempt under Section 1748.1(f)) and (ii) is a content-based restriction. Content-based regulations the court noted are presumptively unconstitutional and need to be the "least restrictive means" to further a "compelling interest."

Even regulations that are neutral as to content and speaker, the court said, can be rendered unconstitutional. Commercial speech is no exception, and restrictions on commercial speech are usually subject to intermediate scrutiny. The State's position that surcharges present a real harm is undermined, the court found, by the fact that the statute exempts government agencies. If the speech is so deceptive and harmful, the court asks, why is the government allowed to engage in it.

Finally, the court found that there must be a reasonable fit between a legitimate state interest and the scope of the speech restriction. If the purpose of the statute is to prevent unfair surprise to consumers at the cash register, the court said, California's law is much broader than necessary. A law mandating disclosure of surcharges would be the most direct way to prevent consumer deception. The method, the court said, also would prevent any encroachment on the freedom of speech.

For these reasons, the court determined that Section 1748.1 violated the First Amendment because it cannot pass the

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intermediate scrutiny needed for a content-based, speaker-specific restriction on consumer speech. The court also found the statute to be unconstitutionally vague, agreeing with the legitimacy of the plaintiffs' plight, *i.e.*, that they must either operate in constant fear of inadvertently describing a dual-pricing policy illegally or refrain from dual pricing. The fact that these retailers and even large national retailers with in-house attorneys are uncertain, is proof that the law is not clear, the court said.

The court declared Section 1748.1 unconstitutional and permanently enjoined its enforcement.

As the court noted, until 2013, major credit card companies had contractual provisions that prohibited retailers from imposing surcharges. Those restrictions were lifted in 2013 and retailers now wishing to charge surcharges must consider state law. In addition to California, about a dozen other states have laws regulating surcharges and/or cash discounts. Challenges similar to the one in *Italian Colors* have been made to some of those laws with varying results (*see, e.g.*, Florida, New York and Texas). Thus, while surcharges no longer may be prohibited in certain states, state (and federal) laws should be reviewed before such charges are imposed. We have reviewed such restrictions for several clients. □

✧ *Mike Tomkies and Margaret Stolar*