DREHER TOMKIES LLP

ALERT

FOR CLIENTS AND FRIENDS OF DREHER TOMKIES LLP

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SECOND CIRCUIT FINDS NEW YORK SURCHARGE PROHIBITION DOES NOT VIOLATE FIRST AMENDMENT

The United States Court of Appeals for the Second Circuit recently held that New York General Business Law Section 518 does not violate the Free Speech Clause of the First Amendment and is not unconstitutionally vague under the Due Process Clause of the Fourteenth Amendment. *Expressions Hair Designs v. Schneiderman,* 2015 WL 5692296 (2nd Cir. Sept. 29, 2015).

Expressions Hair Design involved a challenge filed against the New York Attorney General by five New York retailers — a hair salon, an ice cream parlor, a liquor store, a martial arts studio and an outdoor furniture and billiards company — to New York General Business Law Section 518 on constitutional grounds. Section 518 provides that no seller in any sales transaction may impose a surcharge on a holder who elects to use a credit card in lieu of payment by cash, check, or similar means. A violation of Section 518 is a misdemeanor punishable by a fine not to exceed $500 or a term of imprisonment up to one year, or both.

The plaintiffs' complaint alleged that Section 518 violates the First Amendment's free-speech guarantee, is void for vagueness under the Due Process Clause of the Fourteenth Amendment, and is preempted by the Sherman Antitrust Act. The plaintiffs sought both a declaratory judgment on these claims and an injunction against enforcement of Section 518. The district court found in favor of the plaintiffs on the constitutional claims, permanently enjoined New York from enforcing Section 518 against the plaintiffs and dismissed the preemption claim as moot. On appeal, the Second Circuit vacated, declined to certify questions to the New York state court and remanded for dismissal.

Background

In its opinion the Second Circuit first provided an overview of the "surcharge" issue from the court's perspective. It described how credit card issuers charge merchants a fee each time a consumer uses a credit card to purchase goods or services. These fees, so-called "swipe fees" or "merchant-discount fees," typically are 2-3% of the transaction. It noted that merchants would like to pass these fees on to consumers by charging more to use a credit card (*i.e.,* imposing a so-called "surcharge"). Offering discounts for a consumer's use of cash is an alternative way to pass the cost of credit to customers. But, because of the concept of "loss aversion" (which says that losses loom larger than gains), surcharges are more effective at discouraging credit card use and generally preferred by merchants. Proponents of prohibitions on surcharges, on the other hand, say that merchants tend to impose surcharges higher than necessary to recoup the swipe fees (a problem not encountered when merchants offer a discount). Also, say proponents, dishonest merchants may attempt to impose surcharges surreptitiously at the point of sale. Finally, they suggest discouraging credit card use may negatively affect the economy by hampering retail sales.

In terms of regulation of surcharges, the court observed that credit card issuer's contracts with merchants traditionally prohibited merchants from charging more for credit card transactions. In 1974, the Truth in Lending Act was amended to allow cash discounts. Additional amendments defined "surcharge" and "discount" in terms of "regular price," which eventually was defined in the statute in 1981. This federal ban on surcharges, however, expired in 1984. In response, states enacted bans on credit card surcharges.

The court noted that New York Section 518, which was enacted in 1984, tracked federal law, except that it did not define "surcharge," "discount" and "regular price." The bill summary indicated that merchants would be able to offer a discount for cash. The court observed that there are almost no reported cases involving Section 518 because credit card issuers' contracts with merchants have, until recently, prohibited imposition of surcharges.

First Amendment Challenge

In assessing the plaintiffs' First Amendment arguments, the Second Circuit noted that whether the plaintiffs' were mounting a facial or as-applied attack on Section 518 was unclear. In the end, however, the court concluded that the distinction did not materially affect its analysis, reasoning that Section 518 did not violate the First Amendment as applied to single-sticker-price sellers. Also, the court concluded that any challenge outside the single-sticker-price context fails because Section 518 is "readily susceptible" to a construction under which its application is limited to that context.

With respect to single-sticker-price schemes, the plaintiffs argued that Section 518 restricts commercial speech and does not survive the United States Supreme Court's four-part test traditionally applied to such restrictions. The Second Circuit agreed with

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defendant New York, however, that Section 518 does not regulate speech as applied to single-sticker-price sellers, and therefore it need not examine the Court's four-part test. To reach this conclusion, the Second Circuit noted that prices do not rank as "speech" within the meaning of the First Amendment. This notion, the Second Circuit stated, is clear from the fact that price-control laws have never been thought to implicate the First Amendment. And, the Second Circuit concluded, if prohibiting certain prices does not implicate the First Amendment, then prohibiting certain relationships between prices also does not implicate the First Amendment.

The Second Circuit rejected the plaintiffs' argument that Section 518 burdens protected speech by drawing the line between prohibited "surcharges" and permissible "discounts" based not on economic realities, but on words and labels. By its terms, the court said, Section 518 does not prohibit sellers from referring to credit-cash price differentials as credit card surcharges, or from engaging in advocacy related to credit card surcharges. Rather, it simply prohibits imposing credit card surcharges. As the court pointed out, the only "words and labels" on which the operation of Section 518 depends are (i) the seller's sticker price and (ii) the price the seller charges to credit card customers. Such "words and labels" are merely prices, which the court, as discussed above, determined are not "speech" within the First Amendment. Nor, the court said, are they turned into "speech" when considered in relation to one another. Since Section 518 prohibits only a specific relationship between two prices, it does not regulate speech.

The primary flaw in the plaintiffs' argument, the court stated, is their insistence in equating imposing a credit card surcharge with the words that describe such a pricing scheme (*i.e.,* the term "credit card surcharge"). This, the court said, is the only way to support the plaintiffs' argument that all that Section 518 regulates is what merchants say (*i.e.,* that characterizing the price difference as a cash "discount" is allowed; but characterizing it as a credit "surcharge" is a crime). But, the court said, the plaintiffs simply are wrong. All that Section 518 regulates is the difference between the seller's sticker price and the ultimate price that it charges to credit card customers. Therefore, a seller that imposed a surcharge on a credit card customer is violating Section 518 regardless of what it called the charge. Just as a seller offering a discount is not violating Section 518 regardless of what it called the reduction (including calling it a "credit card surcharge"). The fact that these pricing schemes have different labels, the court noted, does not mean that all they are is labels.

The plaintiffs, the court surmised, view the "surcharges" and "discounts" as just labels because of the differing reactions of consumers to them. Thus, plaintiffs argue, New York is violating the First Amendment by prohibiting the label of "surcharge," while permitting the label of "discount." But, as New York argued, and the court agreed, the mere fact that consumers react negatively to surcharges does not prove that surcharges are speech. That negative reaction, the court determined, is a result of being charged extra, not because surcharges are "communicating" a "message."

Ultimately, the Second Circuit concluded, the plaintiffs failed to provide a reason for the court determine that Section 518, which regulates the relationship between a seller's sticker price and its credit card price, differs from other laws that regulate prices such that the First Amendment is implicit. As applied to single-sticker-prices as described in the plaintiffs' complaint, Section 518, the court concluded, regulates conduct, not speech.

Unconstitutionally Vague Challenge

In examining the plaintiffs unconstitutional vagueness challenges, the Second Circuit found the plaintiffs to be mounting similar attacks to those expressed in its First Amendment arguments and concluded that the challenges fail essentially for the same reasons. Applying traditional standards for facial vagueness challenges, a law is facially unconstitutional if it is impermissibly vague in all of its applications. In other words, it does not have a core meaning that can reasonably be understood.

Here, the Second Circuit concluded, Section 518 clearly has a core meaning that can be understood (*i.e.,* that sellers who post single sticker prices for their goods and services may not charge credit card customers an additional amount above the sticker price that is not also charged to cash customers). The court noted its confidence that ordinarily intelligent sellers will understand how to avoid imposing a credit card surcharge and that New York officials will know whether sellers have violated the law. Thus, the court concluded, Section 518 may validly be applied to single-sticker-price sellers without violating the Due Process Clause. As to a similar challenge in any other context, the court determined it inappropriate to reach the balance of the plaintiffs' vagueness challenge.

Conclusion

As the Second Circuit noted, and as we have discussed before, until 2013, major credit card companies had contractual provisions that prohibited retailers from imposing surcharges. Those restrictions essentially were lifted in 2013 and retailers now wishing to charge surcharges must consider state law. In addition to New York, several other states have laws regulating surcharges or cash discounts. Challenges similar to the one in this case have been made to some of those laws with varying results (*see, e.g.,* California, Florida and Texas). Thus, individual state laws should be reviewed carefully before imposing surcharges. ❑

✧ *Mike Tomkies and Margaret Stolar*