

The Distinction of Six of One, Half a Dozen of the Other. Second Circuit Upholds New York's Prohibition on Credit-Card Surcharges.

After nearly two years in limbo, the Second Circuit Court of Appeals has decided that the New York law that prohibits merchants from imposing a surcharge on customers who use credit cards is constitutional and, therefore, enforceable against all merchants that offer goods and services for sale in New York.

New York General Business Law § 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.

It developed in the 1970s as a potent consumer protection law that ensures the parity of popular payment options. While a purported boon for consumers, merchants were still forced to absorb the credit-card charges its banks charged them for each transaction, without the freedom to transparently share this cost with their customers. To get around Section 518, merchants simply refashioned the transaction into a “cash discount” by adding in the cost of the bank fee to their regular price and offering a lower price for those not paying by credit card. Hence, the widespread use of cash “discounts” on goods like gasoline.

In addition to the statute, the credit-card companies, until recently, refused to allow merchants using their cards to pass on the surcharge to customers. However, in 2013, Visa and MasterCard, pursuant to a settlement, jointly decided to open the door to the use of surcharges on their cards. This, together with the fact that consumers are now using cards more than ever, especially online, frustrated New York merchants who, in an effort to increase profits, wanted to pass the cost of credit-card “swipe fees” onto their customers.

As we [reported](#) in 2013, the case arose when a hair salon, which had posted a notice that a 3% surcharge would be added to credit cards sales, was informed by one of its customers that the sign was in violation of New York law. The Southern District of New York determined the surcharge prohibition violated merchants' First Amendment free speech rights and was unconstitutionally vague under the Fourteenth Amendment's Due Process Clause. The decision primarily rested on the allegedly arbitrary line that the law draws between “surcharges” and “discounts.” For example, Section 518 would allow a merchant to list a sticker price of \$102 but offer cash purchasers a discounted price of \$100. However, Section 518 makes it a crime for a merchant to list a sticker price of \$100 but charge credit-card purchasers a surcharged price of \$102. Thus, leaving the lower court to proclaim, “Alice in Wonderland has nothing on section 518.” Faced with this distinction, the Southern District held that Section 518 ignored economic reality and unconstitutionally focused on the “words and labels” merchants use to describe their prices. The court granted a permanent injunction against enforcement of the law until the lawsuit was concluded. On September 29, 2015, the Second Circuit Court reversed the decision and lifted injunction.

According to the Second Circuit, there are material differences between a “credit-card surcharge” and a “cash discount.” In a rare reference to behavioral economics, the court reasoned that a principal difference is consumers' reactions to the two: because of our inherent aversion to losses, a consumer's behavior is more readily manipulated when the outcome is framed as a “cost” rather than a “savings.” Thus, credit-card surcharges “are more effective than cash discounts at discouraging credit-card use among consumers.” The court noted that, in the aggregate, this discouragement depresses retail sales and stalls the progress of the greater economy. At the same time, at least in the case of a single sticker price, by imposing these surcharges at the point of sale, a potential disconnect can arise between the advertised price and the price actually paid by consumers. This is interesting reasoning since, in the case at hand, the hair salon actually had put up a sign about the surcharge, and so the consumer knew of the final price before the sale was finalized.

In addressing the merchant's First Amendment argument, the court summarily dismissed the assertion that Section 518 is unconstitutional "as applied." In the eyes of the court, Section 518 does not even regulate *speech, per se*, rather it regulates commercial *conduct*. Although necessarily communicated through language, prices, as implicitly conceded by the plaintiffs via their admission that New York could simply require a single charged price, do not in and of themselves implicate a First Amendment issue. In other words, Section 518 does not prohibit the communication of different prices, it prohibits the *imposition* of a higher price beyond the sticker price because of the customer's method of payment—*i.e.*, it affects what merchants can do, not what they can say. Thus, it is not the message but the act of charging a price in excess of the sticker price that is the concern of the law. Indeed, the court argued that, under Section 518, merchants are free to include a surcharge in the sticker price, but they may not impose a charge beyond the sticker price because of the customer's credit-card use. This influence over the relationship between prices, according to the court, is purely conduct and beyond the scope of the First Amendment.

The Second Circuit also found that Section 518 was not unconstitutionally overbroad under the First Amendment. This argument centered on the law's conceivable application to a scenario in which a merchant posts more than one sticker price. According to the plaintiffs, if Section 518 applied to a multiple-sticker-price scenario, it could criminalize speech in a more concrete way than in the single-sticker-price scenario—*i.e.*, the law would criminalize the communication of two prices, not merely the imposition of a higher price.¹ In the court's opinion, the plaintiffs could not show that Section 518 applied to this scenario at all, and, until New York's courts had definitively decided contrarily, it was not the place of the Second Circuit to adopt a more "problematic" interpretation. Instead, the Second Circuit adhered to the presumption that a state's laws are constitutional and thus adopted the narrower, less problematic interpretation of Section 518. As a result, the court declined to go to the merits of either of the First Amendment arguments raised by the plaintiffs.

The Second Circuit was similarly unpersuaded by the plaintiffs' Due Process challenge. The lower court held that Section 518 was unconstitutionally vague because the statute lacks a "core meaning that can be reasonably be understood." The Second Circuit held that the core meaning of the law is obvious: "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 charge to cash customers." Section 518's inclusion of "surcharge" language convinced the court that sellers of "ordinary intelligence" would understand that they could not impose a charge above the usual price, and that New York authorities have sufficient guidance to detect violations of the law.

At the end of the day, in a somewhat surprising turn of events, merchants are again prohibited from charging customers an amount beyond the sticker price simply because those customers decide to pay with a credit card. Cash discounts remain available, as might the use of two sticker prices. Therefore, the temporary window merchants had been afforded to levy surcharges prior to this decision has been closed.

Going forward, given the significant penalty faced by merchants found to violate this prohibition—a \$500 fine and up to one year in prison— New York merchants who seek to recoup credit-card swipe fees should be especially attentive in their pricing schemes to ensure that the sticker price is the credit-card surcharge price and that the only method-of-payment deviation is a cash discount.

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¹ This argument was weak since gas stations all over advertise two prices for the same product, depending on the payment method, without any criminal liability or restrictions.



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