U.S. Supreme Court Questions Constitutionality of New York Credit Card Surcharge Ban as a Regulation of Commercial Speech

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On March 29, 2017, in a potential, or at least temporary, victory for the plaintiffs in *Expressions Hair Design et al. v. Schneiderman*, the United States Supreme Court ruled that New York's credit card surcharge ban regulates speech, not pricing. The Supreme Court vacated the June 2016 decision of the Second Circuit Court of Appeals, which had upheld the statute as a constitutional regulation of pricing, and remanded the case to the Second Circuit with instructions to instead analyze the statute as a commercial speech regulation.

The statute at issue, 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." Violations of § 518 carry misdemeanor criminal penalties of a fine of up to $500, imprisonment up to one year (!), or both.

Merchants accepting payments by credit card typically pay fees of approximately 1% to 5% of the amount of the transaction, depending on a number of factors, such as the brand and type of card, the nature of the merchant's business, and the amount of the transaction. The *Expressions* plaintiffs, a group of New York merchants, wanted to offset their cost of accepting credit cards by imposing a surcharge on customers who paid by credit card. Visa and MasterCard historically prohibited merchants from imposing surcharges for credit card payments, thus rendering state statutes such as § 518 redundant. However, a 2012 anti-trust settlement (currently being re-engineered after being overturned on appeal) led to modifications in the Visa and MasterCard network rules to permit merchants to pass the cost of card acceptance onto customers through a surcharge at the point of payment. This change promptly brought a handful of state statutes banning credit card surcharges, such as § 518, back into the news and the courts.

Although § 518 prohibits merchants from adding surcharges to credit card transactions, it does *not* preclude merchants from raising prices across the board and offering a discount for payment by cash or check. For instance, under § 518, charging $20.00 for a product and adding a $1.00 surcharge for credit card payments would be forbidden, but charging $21.00 for the same product and offering a $1.00 discount for cash or check payment would not. In either instance, however, the fundamental economic reality is *exactly the same*: a customer paying for the product in cash will pay $20.00, while a customer paying for the same product with a credit card will pay $21.00.

The *Expressions* plaintiffs filed a lawsuit against the New York Attorney General in June 2013 in the United States District Court for the Southern District of New York, seeking two forms of relief: first, a declaration that § 518 is unconstitutional and preempted by other federal laws, and second, an injunction preventing the state from enforcing the statute. The plaintiffs asserted, among other things, that § 518 unconstitutionally restricts the manner in which they can communicate their pricing to customers. In the hypothetical scenario above, customers would pay the exact same prices under either the (forbidden) surcharge arrangement or the (permissible) discount structure. The only difference is in the words used to define the two pricing schemes. That seemingly arbitrary distinction, the plaintiffs argued, infringed on their First Amendment rights. The merchants – for obvious reasons – wanted the ability to maintain and post their usual prices, but charge an additional fee for credit card payments to properly reflect the added costs imposed by the credit card networks.

The merchants prevailed in the District Court. That court adopted the merchants' view that, among other infirmities, § 518 is unconstitutional because it impermissibly regulates speech by drawing an arbitrary distinction between the words "discount" and "surcharge" even though there is no difference whatsoever between the economic realities of the two pricing structures.

The Second Circuit reversed the District Court, holding that § 518 is *not* unconstitutional. Rather, the Second Circuit ruled that § 518 is simply a pricing regulation and that it is "far from clear" that the statute prohibits a dual pricing scheme (i.e., posting separate prices for cash and credit, as opposed to a single price plus a surcharge for a particular mode of payment). The Supreme Court granted certiorari to review the Second Circuit's decision.

In the Supreme Court, the merchants waived a facial challenge to the overall constitutionality of § 518, and instead challenged the statute only as it has been or could be applied to them in one particular pricing scenario: posting a single cash price and an additional credit card surcharge (either as a percentage of the price or a fixed amount). The Supreme Court agreed with the Second Circuit's determination that § 518 would bar this type of pricing arrangement. However, the Supreme Court rejected the Second Circuit's holding that § 518 is simply a pricing regulation and instead held that § 518 regulates speech because it regulates "the ***communication*** of prices ***rather than prices themselves …***" (emphasis added).

The Supreme Court's determination that § 518 regulates commercial speech is not the end of the story. While some commentators have predicted that the *Expressions* plaintiffs have a strong chance of prevailing on remand, the Supreme Court did not offer any insight on whether § 518 is a constitutional regulation of commercial speech. The commercial speech doctrine is not as well-developed as the Supreme Court's jurisprudence regarding individual speech, nor are the protections as robust. The Supreme Court first ruled in 1976 that commercial speech is entitled to some level of First Amendment protection, holding that commercial speech may not be banned in its entirety. In 1980, the Court announced a three-step test for ascertaining the constitutionality of regulations of commercial speech. Under that test, a statute that regulates commercial speech, such as § 518, is only constitutionally permissible if (1) a substantial governmental interest is at stake, (2) the speech regulation at issue directly advances that substantial governmental interest, and (3) the regulation is narrowly tailored – that is, no more extensive than necessary to advance that interest. In 1989, the Court refined the "narrowly tailored" prong of the test, providing that the regulation must bear a "reasonable fit" to the governmental interest it serves.

The Supreme Court remanded the case to the Second Circuit to consider the constitutionality of § 518 as a regulation of commercial speech, as applied to the "single price plus surcharge" arrangement described above. Under the commercial speech doctrine, the Second Circuit can only uphold § 518 if it first finds that prohibiting such a pricing regime serves a substantial governmental interest, and then finds that the prohibition in § 518 bears a reasonable fit in furtherance of that interest.

The Attorney General will likely assert on remand, consistent with prior arguments in the *Expressions* litigation, that § 518 serves a substantial governmental interest by protecting consumers from being misled by merchants' advertised prices, only to learn at the time of payment that they will be charged an added fee for paying by credit card. It is difficult to fathom consumers requiring "protection" from a modest surcharge, particularly where the applicable Visa and MasterCard rules require clear signage advising consumers of it at the point of sale – and where consumers have the option not to proceed with a purchase if they dislike the surcharge. Absent a threshold finding that § 518 serves a substantial governmental interest, such as consumer protection, the statute would not survive the plaintiffs' challenge. However, if the Second Circuit *does* find that § 518 serves the substantial governmental interest of consumer protection (or otherwise), it very likely would also find that the statute furthers and bears a "reasonable fit" to that interest, and thus satisfies the other two prongs of the constitutional standard.

In light of the Supreme Court's directive to consider § 518 as a speech regulation, it is entirely possible that the Second Circuit will reverse its prior holding on remand and will instead uphold the District Court's determination that § 518 is unconstitutional as applied to the "single price plus surcharge" pricing arrangement. It is also possible that the Second Circuit will follow the admonition in the concurring opinions that the Supreme Court should have remanded the case back to the Second Circuit with an instruction to certify to the New York Court of Appeals the question of how § 518 operates: that is, which pricing schemes, if any, § 518 would permit and which it would prohibit. However, as other commentators have noted, the Supreme Court's opinion contains so little guidance on the underlying First Amendment issues that there is no guarantee of what the Second Circuit will do on remand.

Two additional petitions for certiorari are pending in the Supreme Court with respect to conflicting decisions by the Fifth Circuit, which upheld the Texas surcharge ban as a constitutional pricing regulation, and the Eleventh Circuit, which struck down the Florida surcharge ban as an unconstitutional restriction on merchants' speech. In light of the Supreme Court's decision in *Expressions*, it is possible that the Court will summarily reverse the Fifth Circuit with similar instructions to consider the Texas statute as a speech regulation. Granting certiorari in the Eleventh Circuit case, which considered Florida's surcharge ban as a speech regulation, would provide the Supreme Court an opportunity to expand on the application of the commercial speech doctrine to such regulations.

In summary, if the Second Circuit strikes down § 518, at least as applied to the pricing scheme at issue in *Expressions*, the takeaway for merchants accepting credit cards from customers located in New York (debates regarding the applicability of § 518 to B2B transactions aside) will be that § 518 will no longer prohibit the posting of a single price and the imposition of a surcharge atop that price for payment by credit card. Time will tell whether that is the outcome here.

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