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Freedom to Surcharge—Ninth Circuit Rules Businesses' Can Charge Card Fees

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Seyfarth Synopsis: Ninth Circuit upholds district court decision granting five businesses injunctive relief, finding that state law banning credit card surcharges is unconstitutional as applied to the five businesses.

In a unanimous decision last week, a panel of the Ninth U.S. Circuit Court of Appeals affirmed a district court's ruling holding that California's law barring businesses from imposing a credit card surcharge is unconstitutional. In *Italian Colors Restaurant v. Xavier Becerra, Attorney General*, five California businesses challenged California Code Section 1748.1, which prohibits retailers from imposing a surcharge on customers who make payments with credit cards, but permits discounts for payments by cash or other means. The court heard from the five businesses who all desire to post a single price on their goods and charge an extra fee on customers who use credit cards, without the threat of an enforcement action for violating California's surcharge statute.

Plaintiffs' story

Plaintiffs sued the Attorney General of California alleging that the statute restricts free speech in violation of the First Amendment and that it is unconstitutionally vague under the Due Process Clause of the Fourteenth Amendment. Plaintiffs explained that they pay thousands of dollars each year on credit fees incurred when customers swipe their plastic to make a purchase. To account for these fees, the plaintiffs increase their "sticker-price" for products. Customers who pay with cash or debit cards are offered a discount from these escalated prices. The businesses would rather charge customers directly a surcharge for credit cards than offer a discount because: (i) credit card surcharges more effectively communicate to consumers the high cost of credit cards; (ii) the fees require businesses to increase their prices to accommodate the credit cards costs, which makes their goods look more expensive; and (iii) a credit card surcharge would be more effective than offering a cash discount in encouraging consumers to use cash.

Statute history

In 1976, the Truth-in-Lending Act (TILA) prohibited retailers from imposing a charge on a cardholder who elected to use a credit card in lieu of cash, check, or payment of the like. The federal ban expired in 1984. Despite this change, California and other states maintain a local law barring business from imposing a surcharge on a customer who uses a credit card in lieu of another form of payment. But California's law permits businesses to offer discounts for the purposes of inducing payment by

cash, check, or similar means not involving a credit card. Violators of the law are liable for three times actual damages, plus the cardholder's attorney's fees and costs in an action enforcing the law. The stated purpose of the statute is to promote the effective operation of the free market and protect consumers from deceptive price increases.

Court's review

The panel examined the California statute under an "as-applied" challenge, limiting its review to whether the statute was unconstitutional as applied to the businesses, rather than a facial challenge, which considers whether the statute is always unconstitutional. The court noted that the activity that Plaintiffs' sought—charging credit cards users more than cash users—is not unlawful. Additionally, while the Attorney General argued that the statute was intended to protect consumers, the panel found that the conduct intended by the businesses was not unlawful or misleading. In fact, the court found that the statute does not promote the accuracy of information in plaintiffs' places of business. To that end, the court found that the statute was more extensive than necessary and did not advance the state's interest because California has other means of preventing consumers' deception. For example, the court suggested that "the state could simply ban deceptive or misleading surcharges." In all, the court held that California could not prevent plaintiffs from communicating credit card surcharges to their customers and awarded the plaintiffs' injunctive relief.

The trend

The Ninth Circuit's decision is the latest in a series of rulings in other states, including Florida and New York, which have indicated that the surcharge ban is unconstitutional. Major credit card companies have also generally eliminated from their contracts language that bans retailers from imposing surcharges on customers using credit cards. However, some card companies require advance notice and other disclosure requirements from the business if the business intends to impose a surcharge. Additionally, certain credit card companies prohibit surcharging debit cards, while other card companies require merchants that choose to surcharge credit cards to surcharge all payment card options, including debit cards. This effectively makes it impossible for most merchants to surcharge credit card transactions and still comply with the various credit card merchant agreements. It may be a stretch to say that customers will start using cryptocurrency, but customers may be more inclined to pay with cash, debit cards, or checks to avoid the credit card fees if more businesses add a surcharge to sticker-prices for those who pay with credit cards. Thus, notwithstanding the Ninth Circuit's ruling, businesses in California should think about the implications of imposing a surcharge that may affect both their commercial and customer relations.

Businesses who maintain credit card payment systems and credit card companies who contract with retailers that accept their credit cards are welcome to reach out to us for further guidance and compliance recommendations on this issue.

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