# Banking and Finance Law Daily Wrap Up, CREDIT, DEBIT AND GIFT CARDS—E.D. Cal.: California's law restricting credit card surcharges struck down as unconstitutional, (Mar. 30, 2015)

Banking and Finance Law Daily Wrap Up

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By Thomas G. Wolfe, J.D.

The U.S. District Court for the Eastern District of California has held that a California law restricting surcharges on credit cards is unconstitutional, asserting that the statutory provision not only placed an impermissible burden on commercial speech in violation of the First Amendment but also was unconstitutionally vague. In permanently enjoining enforcement of the state statute, the federal court granted summary judgment in favor of five California businesses and their respective owners in an action brought against the California Attorney General in her official capacity (*Italian Colors Restaurant v. Harris*, March 25, 2015, England, M.).

**Complaint.** The five California businesses—a restaurant, gas station, dry cleaners, transmission repair business, and web design company—and their respective owners filed an action in federal court against the California Attorney General. The merchants alleged that California's law governing surcharges on credit cards (Cal. Civ. Code §1748.1) violated the First Amendment to the U.S. Constitution as "an unlawful restriction on commercial speech because the statute regulates how retailers can *describe* the price difference between cash and credit purchases." In addition, the merchants contended that since a statute must clearly delineate the conduct it proscribes, in keeping with principles of due process, the California provision was unconstitutionally vague.

**California statute.** The applicable provision of the California law (Cal. Civ. Code §1748.1(a)) provides: "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. 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."

According to the court's depiction of the operation of the statutory provision, "a retailer could charge $102 for a product and give a $2 discount, but could not charge $100 and impose a $2 surcharge, despite the situations being mathematically equivalent. Thus, the statute restricts how this $2 price difference is presented to the consumer."

**Backdrop.** In its opinion, the court pointed out that, until fairly recently, "state 'no surcharge' statutes were redundant because credit card companies had contractual provisions that prohibited retailers from imposing surcharges. However, in 2013, a nationwide settlement agreement with the credit card companies resulted in the removal of these contractual provisions…Instead, retailers are now required to engage in truthful and prominent disclosure of surcharge information to consumers and cannot recoup more than the cost of the merchant fees [also known as swipe fees] as a surcharge."

As the court observed, in light of the nationwide settlement with the credit card companies, the five businesses in the action were now "contractually permitted" to impose surcharges, but initiated the lawsuit, at least in part, to ensure that doing so would not somehow be considered a violation of the California law.

**Cal. AG's position.** In arguing that the California statute (Cal. Civ. Code §1748.1) should be upheld as constitutional, the California AG pointed to the legislative history and purpose of the law to prevent a "bait and switch" situation in which a cardholder would be surprised by an additional charge at the cash register; retailers would only be allowed to "discount" the purchase price for non-credit card users.

In the California AG's view, section 1748.1 of the California Civil Code did not instruct retailers about "how to assign their prices or otherwise communicate pricing or cost information to their customers." Rather, because only "economic activity" was prohibited by the California law, no free-speech issue was implicated. Consequently, the California statute was subject only to a "rational basis review," the California AG contended. The court disagreed.

**First Amendment violation.** After first determining that the businesses and owners had standing to bring their action against the California AG in her official capacity, the court addressed the issue of whether the statutory restriction on surcharges imposed an impermissible burden on commercial speech in violation of the First Amendment. The court ruled there was a First Amendment violation.

Contrary to the California AG's stance, the court found that section 1748.1 of the California Civil Code was *not* an "economic regulation that controls what is charged or paid for something." Rather, "what is regulated is how those prices are conveyed to customers, not the prices themselves." Essentially, the merchants were not truly "free to express themselves regarding the California's no-surcharge law."

In reaching this conclusion, the court determined, among other things, that: (i) the California provision singled out "a specific class of speakers," and involved a "content-based restriction"; (ii) as a restriction on commercial speech, the statute was subject to the "intermediate scrutiny" test and did not pass that test; and (iii) if the statute's purported purpose was to prevent deception and "unfair surprise" to consumers at the cash register, then "a law mandating disclosure of surcharges would be the most direct way to prevent consumer deception" and would also "prevent any encroachment on the freedom of speech."

**Unconstitutionally vague.** The merchants successfully argued that the California law did not "clearly define the line between a permissible 'surcharge' and a mathematically equivalent but illegal 'discount.'" In rejecting the California AG's argument that many of the merchants' contentions about the vagueness of the California statute were "hypothetical," the court emphasized that "[t]hese retailers would like to have a pricing system where a surcharge is imposed for credit card purchases, but do not feel confident that they could do so lawfully. The fact that retailers—even large national retailers with teams of in-house attorneys—do not use a dual-pricing system under the current law due to fear of enforcement is proof that the law is not clear."

The case is No. 2:14-cv-00604-MCE-DAD.

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Companies: Family Life Corporation; Italian Colors Restaurant; Laurelwood Cleaners, LLC; Leon's Transmission Service, Inc.; Stonecrest Gas & Wash

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