IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF CALIFORNIA

ITALIAN COLORS RESTAURANT, ALAN CARLSON, STONECREST GAS & WASH, SALAM RAZUKI, LAURELWOOD CLEANERS, LLC, JONATHAN EBRAHIMIAN, LEON'S TRANSMISSION SERVICE, INC., VINCENT ARCHER, FAMILY LIFE CORPORATION d/b/a FAMILY GRAPHICS, TOSHIO CHINO,

Plaintiffs,

v.

KAMALA D. HARRIS, in her official capacity as Attorney General of the State of California,

Defendant.

Case No.: 14-cv-00604

MEMORANDUM OF LAW IN SUPPORT OF PLAINTIFFS' MOTION FOR SUMMARY JUDGMENT

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INTRODUCTION

Each time a merchant swipes a credit card, the merchant incurs a "swipe fee." These fees are typically passed on to all consumers, in the form of higher prices. Merchants who wish to pass on the cost of swipe fees only to customers who pay with credit cards, however, may lawfully do so by charging two different prices depending on how the consumer pays: a higher price for using a credit card and a lower one for using something else (cash, a check, or a debit card).[1]

But a California statute, Cal. Civ. Code § 1748.1, seeks to control how a merchant may *communicate* that dual pricing to consumers. It allows a merchant to "offer discounts for the purpose of inducing payment by cash, check, or other means not involving the use of a credit card," but forbids the imposition of a mathematically equivalent "surcharge on a cardholder who elects to use a credit card in lieu of payment by cash, check, or similar means." Cal. Civ. Code § 1748.1(a). A "surcharge" and a "discount" are just two ways of framing the same price information—like calling a glass half full instead of half empty. Experience, though, shows that consumers react differently to the two labels, perceiving a "surcharge" as a penalty. Precisely because the "surcharge" label is more effective at conveying the cost of credit cards and discouraging their use, the credit-card industry has long insisted that it be suppressed.

California's no-surcharge law in effect says to merchants: You may tell your customers that they are paying "$2 less" for not using credit, but you may not tell them that they are paying "$2 more" for using credit—even though they *are* paying more for using credit. Liability for the merchant thus turns on the language used to describe identical conduct, and nothing else.

A hypothetical example illustrates the point. Suppose a merchant charges two different prices depending on how the customer pays—$100 for cash; $102 for credit. If the merchant says

[1] As shorthand, we refer in this brief to cash, checks, and debit cards simply as "cash," unless context dictates otherwise.

that the price is $102 and there's a $2 "discount" for paying in cash, the merchant has complied with the law. But if the merchant instead says that the price is $100 and there's a $2 "surcharge" for using a credit card, the merchant has violated section 1748.1. In the two scenarios, the conduct is identical: The merchant charges the customer $100 for cash or $102 for credit. The only difference is how the merchant communicates that information to customers—that is, the content of the merchant's speech.

Like New York State's identical no-surcharge law, section 1748.1 turns on a "virtually incomprehensible distinction between what a vendor can and cannot tell its customers." *Expressions Hair Design v. Schneiderman*, 975 F. Supp. 2d 430, 436 (S.D.N.Y. 2013) (reproduced at Gupta Decl., Ex. A). For that reason, District Judge Jed S. Rakoff struck down New York's law as an impermissible speech restriction and as unconstitutionally vague. *Id.* Judge Rakoff is not alone in that assessment. District Judge John Gleeson, who presided over challenges by merchants to Visa and MasterCard's no-surcharge rules, expressed his strong agreement with *Expressions*, pronouncing no-surcharge laws "anti-consumer" and "irrational," and finding "good reason to believe" that they will not survive constitutional scrutiny. *In re Payment Card Interchange Fee & Merchant Discount Antitrust Litig.*, 986 F. Supp. 2d 207, 2013 WL 6510737, *19–20 (E.D.N.Y. 2013).

This recognition is not new. The earliest reported prosecution under a no-surcharge law targeted a cashier who made the mistake of truthfully telling a customer that it would cost "five cents 'extra'" to pay with a credit card instead of saying it would cost a "nickel less" to use cash. *People v. Fulvio*, 517 N.Y.S.2d 1008, 1010, 1014 (N.Y. Crim. Ct. 1987). That case yielded the same judicial assessment—that "precisely the same conduct" is considered either illegal or permissible "depending only upon the *label* the individual affixes to his economic behavior." *Id.* at 1011. "[I]t is not the *act* which is outlawed, but the *word* given that act." *Id.* at 1015.

Because California's no-surcharge law "draws the line between prohibited 'surcharges' and permissible 'discounts' based on words and labels, rather than economic realities," it "clearly regulates speech, not conduct, and does so by banning disfavored expression." *Expressions*, 975 F. Supp. 2d at 444. And because the law is far broader than necessary to advance any interest in preventing deception, it cannot satisfy the heightened scrutiny traditionally applied to commercial-speech restrictions, and thus cannot satisfy the First Amendment. *See Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of New York*, 447 U.S. 557 (1980).

The no-surcharge law is also unconstitutionally vague. It does not clearly define the line between a permissible "surcharge" and a mathematically equivalent but illegal "discount." Yet that fuzzy semantic line marks the difference between what is lawful and what is not. The law is so vague that merchants are forced either to operate in constant fear of inadvertently describing a dual-pricing policy in an illegal way or to refrain from dual pricing altogether, as many of the plaintiffs here have done, even though it is legal. Because the California no-surcharge law violates the First Amendment and is unconstitutionally vague, this Court should enter summary judgment in favor of the plaintiffs and enjoin the defendants from enforcing the law.

BACKGROUND AND STATEMENT OF FACTS

American merchants pay some of the highest swipe fees in the world—around 3% of every credit-card transaction. *See, e.g.*, Carlson Decl. ¶ 4; Chino Decl. ¶ 3. This amounts to well over $50 billion a year in swipe fees. 156 Cong. Rec. S4839 (daily ed. June 10, 2010). The main reason swipe fees are so high is that they are kept hidden from consumers—the very people who decide which payment method to use and thus determine whether a fee will be incurred in the first place. As Federal Reserve economists have noted: "What most consumers do not know is that their decision to pay by credit card involves merchant fees, retail price increases, a nontrivial transfer of income from cash to card payers, and consequently a transfer from low-income to

high-income consumers." Schuh, Shy, & Stavins, *Who Gains and Who Loses from Credit Card Payments?*, Federal Reserve Bank of Boston, at 1 (2010). Merchants cannot effectively communicate the cost of credit because the credit-card companies have succeeded in insisting that any price difference be labeled as a "discount" for cash rather than a "surcharge" on credit.

A. The Communicative Difference Between "Surcharges" and "Discounts"

A "surcharge" on credit and a "discount" for cash "are different frames for presenting the same price information—a price difference between two things." Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 UCLA L. Rev. 1321, 1351–52 (2008). They are identical in every way except one: the *label* that the merchant uses to communicate the difference.

But labels matter. "[T]he frame within which information is presented can significantly alter one's perception of that information, especially when one can perceive the information as a gain or a loss," as with the price difference between using cash and using credit. Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence Of Market Manipulation*, 112 Harv. L. Rev. 1420, 1441 (1999). Because of this well-established cognitive phenomenon, "people have stronger reactions to losses and penalties than to gains" and thus "react very differently to surcharges and discounts," even though they present the exact same pricing information. Adam J. Levitin, *The Antitrust Super Bowl: America's Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit*, 3 Berkeley Bus. L.J. 265, 280 (2006). Consumers are more likely to respond to surcharges (which are perceived as *losses* for using credit) than to discounts (which are perceived as *gains* for not using credit). *Id.* Research shows just how wide this gap is. In one study, 74% of consumers had a negative or strongly negative reaction to credit surcharges, while fewer than half had a negative or strongly negative reaction to cash discounts. *Id.* at 280–81. That difference—the difference in how the same pricing information is understood by consumers—influences their behavior, making "surcharges" more effective at communicating the costs of credit to consumers.

B. The History of No-Surcharge Rules

The effectiveness of surcharges is why credit-card companies have long opposed them: Surcharges inform consumers of the costs of credit, letting consumers decide for themselves whether credit's benefits outweigh its costs, and thereby create meaningful competition. Regulating speech, however, was not the credit-card industry's first strategy in trying to conceal the cost of credit from consumers. In the early days of credit cards, credit-card companies banned any attempt at differential pricing between credit and cash in their contracts with merchants. *See* Kitch, *The Framing Hypothesis: Is It Supported by Credit Card Issuer Opposition to a Surcharge on a Cash Price?*, 6 J.L. Econ. & Org. 217, 219–20 (1991). That changed in 1974 when two things happened: (1) American Express agreed to drop its contractual ban on differential pricing in response to a federal antitrust lawsuit brought by Consumers Union, *id.* at 225, and (2) Congress then enacted legislation protecting the right of merchants to have dual-pricing systems, amending the Truth in Lending Act to provide that "a card issuer may not, by contract, or otherwise, prohibit any such seller from offering a discount to a cardholder to induce the cardholder to pay by cash, check, or similar means rather than use a credit card." 15 U.S.C. § 1666f(a).

Only then did the credit-card industry, seizing on Congress's use of the word "discount," shift its focus to the way merchants could *label* and *describe* credit pricing to consumers. Aware that how information is presented to consumers can have a huge impact on their behavior—and that many merchants would avoid dual pricing altogether if "surcharges" were outlawed—the credit-card lobby "insist[ed] that any price difference between cash and credit purchases should be labeled a cash discount rather than a credit card surcharge." Tversky & Kahneman, *Rational Choice and the Framing of Decisions*, 59 J. Bus. S251, S261 (1986); *see also* Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. Econ. Behavior & Org. 39, 45 (1980) ("[T]he credit card lobby

turned its attention to form rather than substance," insisting "that any difference between cash and credit card customers take the form of a cash discount rather than a credit card surcharge.").

For a while, this intensive lobbying paid off. In 1976, Congress enacted a temporary ban on credit-card surcharges, but not cash discounts. *See* Pub. L. No. 94–222, 90 Stat. 197. But by the early 1980s, opposition to the ban intensified as the Reagan Administration, consumer groups, and retailers all urged Congress to let it lapse.

A few examples: A member of the Federal Reserve Board, which unanimously opposed the ban, testified about "the obvious difficulty in drawing a clear economic distinction between a permitted discount and a prohibited surcharge." Gupta Decl., Ex. B, at 9. "If you just change the wording a little bit," she explained, "one becomes the other." *Id.* at 22. The Board thus proposed "a very simple rule": that both surcharges and discounts be allowed, and "that the availability of the discount or surcharge be disclosed to consumers." *Id.* at 10. President Reagan's Federal Trade Commission chairman agreed, observing that "a discount and a surcharge are equivalent concepts" but "one is hidden in the cash price and the other is not," meaning that a ban on "surcharges" prohibited merchants from disclosing to their customers the true cost of credit. S. Rep. 97-23, at 10 (1981).

The major consumer-advocacy groups took the same position, and urged Congress to let the ban lapse and allow surcharges. A Consumers Union representative, for example, testified that the difference between surcharges and discounts "is merely one of semantics, and not of substance." Gupta Decl. Ex. B, at 98. But "the semantic differences are significant," she emphasized, because "the term 'surcharge' makes credit card customers particularly aware that they are paying an extra charge," whereas "the discount system suggests that consumers are getting a bargain, and downplays the truth." *Id.* A Consumer Federation of America advocate put it more pithily: "one person's cash discount may be another person's surcharge." *Id.* at 90.

"Removing the ban on surcharges," he explained, "is an important first step" to "disclos[ing] to consumers the full" cost of credit so that they can "make informed judgments." *Id.* at 92.

On the other side of the debate, American Express and MasterCard "wholeheartedly" and "strongly" supported the ban, even though they understood that, from a "mathematical viewpoint," "there is really no difference between a discount for cash and a surcharge for credit card use." *Id.* at 43, 55. And the big banks, like the credit-card giants, supported treating "surcharges" and "discounts" differently because a surcharge "makes a negative statement about the card to the consumer." *Id.* at 32. Surcharges, a banking lobbyist openly explained, "talk against the credit industry." *Id.* at 60. In 1984, Congress let the ban on surcharges lapse. Levitin, *Priceless?*, 55 UCLA L. Rev. at 1381.

The credit-card companies then turned to the states, convincing fewer than a dozen (including California) to enact no-surcharge laws of their own. To create the illusion of grassroots support for these laws, American Express and Visa hired the renowned public-affairs firm Hill & Knowlton to invent a fake consumer group called "Consumers Against Penalty Surcharges." *See* Gupta Decl., Ex. C (internal memo touting the firm's work "put[ting] together 'Consumers Against Penalty Surcharges' for a coalition of credit card companies"); AP, *Consumers Gain Friends in Credit Card Fight*, Ocala Star-Banner, Apr. 2, 1984 (noting that the group was "bankrolled by American Express and Visa"). In California, this group formally sponsored the no-surcharge law as part of its goal of achieving "a permanent ban at the federal level"—like the one previously enacted "[a]t the behest of the card issuers." Gupta Decl., Ex. D (Enrolled Bill Report, at 2). But the overwhelming majority of real consumer groups (including Consumers Union and Consumer Federation of America) opposed the law because surcharge bans discourage merchants from making the costs of credit transparent, which increases those costs and results in an enormous "invisible subsidy" paid by all consumers whenever they make a purchase—the same reasons

several national consumer groups recently filed an amicus brief supporting the merchants in *Expressions*. *Id.* Exs. E & F.

In 1985, one year after expiration of the temporary federal ban, California's no-surcharge law was enacted. *See* Cal. Civ. Code § 1748.1. Despite the strong consumer opposition, the law says that its purpose is "to promote the effective operation of the free market and protect consumers from deceptive price increases for goods and services by prohibiting credit card surcharges and encouraging the availability of [cash] discounts." *Id.* § 1748.1(e).

Around the same time, the major credit-card companies "began including contractual no-surcharge provisions in their agreements with retailers." *Expressions*, 975 F. Supp. 2d at 439. These private no-surcharge rules remained in effect until 2013, when Visa and MasterCard rescinded them in response to major federal antitrust litigation, *Payment Card Interchange*, 2013 WL 6510737, and American Express agreed to do the same, *In re American Express Anti-Steering Rules Antitrust Litig.*, No. 11-MD-2221 (E.D.N.Y.), ECF No. 306. As a result, state no-surcharge laws like California's—previously largely redundant—have suddenly sprung to life.[2]

C. The Plaintiffs

The merchant plaintiffs in this case seek to use the surcharge label for the same reason the credit-card industry has long opposed it (first through an outright ban on dual pricing, and then through a speech code): because it most effectively communicates the costs of credit to consumers, and thus most effectively alters behavior. The plaintiffs' declarations bear this out. Italian Colors Restaurant, for instance, has long advocated for making the costs of credit cards transparent, even serving as the lead plaintiff in the recent nationwide antitrust lawsuit against

[2] Because of the credit-card companies' former contractual rules, section 1748.1 has a sparse enforcement history. In 2001, someone brought a class action against a gas station that listed a "cash price" and a "credit price" but didn't characterize the difference in any particular way. *Thrifty Oil v. Superior Court*, 91 Cal. App. 4th 1070, 1073–78 (2d Dist. 2001). The court held that this "two-tier pricing system" was permissible. *Id.* at 1078.

American Express, which went to the U.S. Supreme Court and ultimately caused the credit-credit company to agree to drop its contractual no-surcharge rules. But Italian Colors may not take advantage of the relief it obtained because California prohibits framing the cost of credit "as a 'surcharge' rather than a 'discount.'" Carlson Decl. ¶ 8. The restaurant's owner understands that he may lawfully tell customers that he offers a mathematically equivalent cash "discount," but he does not want to say that. *Id.* ¶¶ 10–12. What he wants to say is that credit costs *extra*—not that cash costs *less*—and to use that framing to persuade consumers to switch to cheaper payment forms. *Id.* That truthful speech is exactly what section 1748.1 prohibits.

Another plaintiff, Stonecrest Gas and Wash, wants to say the same thing. *See* Razuki Decl. ¶ 6. It charges two different prices to customers depending on how they pay: one for using cash and another for using credit. *Id.* ¶ 5. But because of California's no-surcharge law, Stonecrest is forced to communicate the price difference in the state's preferred way—as a cash "discount," not a credit "surcharge." Stonecrest would like to change that. It believes that "framing the price difference as a 'surcharge' would be more effective" at conveying its message, and so it would like to designate the cost of credit as "an extra fee" on its labels and signs, but section 1748.1 outlaws that way of describing dual pricing.

The other plaintiffs are in the same boat. They do not want to express the credit-card price as the "regular price" and the cash price as a "discounted price" because they believe that is an ineffective way to communicate their message. Instead, as the proprietors of Laurelwood Cleaners and Leon's Transmission Service explain, they want to label the cash price as the "regular price" and to explain to customers that they must pay an "extra fee" or "surcharge" for using credit cards. Archer Decl. ¶ 10; Ebrahimian Decl. ¶ 7; *see also* Chino Decl. ¶ 5. That is the open and honest messaging that the merchants wish to convey. But because section 1748.1 bans that messaging, those plaintiffs have decided to refrain from dual pricing entirely.

Another reason they refrain from dual pricing is that they are unable to discern what speech section 1748.1 makes lawful and what it prohibits. Laurelwood's owner "find[s] the difference between these two labels to be confusing" and thinks "it would be difficult for [his] staff to always" obey the distinction, while Leon's is similarly "concerned that [its] employees might describe the cost of credit in a way that might violate the law." Archer Decl. ¶ 13; Ebrahimian Decl. ¶ 6. The law's vagueness leaves these merchants uncertain as to whether they could implement a dual-pricing system in a lawful way. *Id.*

ARGUMENT

I. California's No-Surcharge Law Violates the First Amendment.

A. The no-surcharge law is a content-based speech restriction subject to heightened First Amendment scrutiny.

Whenever the government creates restrictions that turn on the content of a speaker's words, the First Amendment "requires heightened scrutiny." *Sorrell v. IMS Health Inc.*, 131 S. Ct. 2653, 2663–64 (2011). This scrutiny applies to any law whose "purpose and practical effect" is "to suppress speech" based on its content, even if the law "on its face appear[s] neutral." *Id.* In other words, "[t]he fact that [a] statute's practical effect may be to discourage protected speech is sufficient to characterize [it] as an infringement on First Amendment activities." *FEC v. Mass. Citizens for Life, Inc.*, 479 U.S. 238, 255 (1986) (plurality op.). Content-based speech restrictions are "presumptively invalid," and in many cases "it is all but dispositive to conclude that a law is content-based." *Sorrell*, 131 S. Ct. at 2667 (internal quotation marks omitted).

"Commercial speech is no exception." *Id.* at 2664. The Supreme Court has long held that this speech—including speech conveying "price information" to consumers—is "protected by the First Amendment." *Va. Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 770 (1976). So if a law's "purpose and practical effect" are to restrict commercial speech based on its

content, the law must withstand heightened scrutiny to satisfy the First Amendment. *Sorrell*, 131 S. Ct. at 2663. Here, the "purpose and practical effect" of California's no-surcharge law show that it is a content-based (and speaker-based) restriction on speech.

1. Practical effect. As discussed above, section 1748.1 does not prevent merchants from charging different prices depending on whether a customer pays with cash or credit, or from setting those prices as high or low as they wish. All the law regulates is how merchants may *communicate* those prices to customers: Characterizing the price difference as a cash "discount" is favored; characterizing it as a credit "surcharge" is banned. The law thus prohibits a certain class of speakers (merchants) from communicating a certain disfavored message (identifying the added cost of credit as a surcharge) and does so to discourage consumers from acting on that message (by deciding not to use a credit card). *Id.* Nothing more is needed to show that the law is "directed at certain content and is aimed at particular speakers." *Id.* at 2665; *see S.O.C., Inc. v. County of Clark*, 152 F.3d 1136, 1145 (9th Cir. 1998) (finding a law content-based because it "distinguish[ed] between [two] forms of expression" and "an officer who seeks to enforce the [law] would need to examine the contents of the [communication] to determine" its legality); *Fonti v. City of Menlo Park*, 146 F.3d 629, 636 (9th Cir. 1998) (finding a law "content-based because a law enforcement officer must read a sign's message to determine if the sign" was legal); *Expressions*, 975 F. Supp. 2d at 444 (holding that New York's indistinguishable no-surcharge law "clearly regulates speech" based on content because it "draws the line between prohibited 'surcharges' and permissible 'discounts' based on words and labels, rather than economic realities"); *Fulvio*, 517 N.Y.S.2d at 1015 ("[I]t is not the *act* which is outlawed [by New York's law], but the *word* given that act.").

The no-surcharge law also has the practical effect of blocking merchants from communicating the cost of credit to credit-card customers "in the forum most likely to capture

[their] attention"—as a line item on the receipt. *BellSouth v. Farris*, 542 F.3d 499, 505 (6th Cir. 2008). Communicating the cost of credit as a line item on the receipts of only those customers who pay in cash (which is what conveying the cost as a "discount" would do) is ineffective because those customers are *already* using cash. Customers who use credit—the target of the merchants' message—are kept "in the dark" because their receipts say nothing about how much of their purchase was the result of their decision to pay with a credit card. *Id.* So it does not matter if merchants "may express [their] views in some other forum or by some other means. Here, the speech is prohibited in the most logical and relevant place for it to occur." *Motor Vehicle Mfrs. Ass'n v. Abrams*, 684 F. Supp. 804, 807 (S.D.N.Y. 1988). The no-surcharge law's prohibition on the use of a particular method of communication—conveying the cost of credit as a surcharge on signs and as a line item on customer receipts—triggers First Amendment scrutiny "even if other, but less satisfactory, methods of communication exist." *Id.*

2. Purpose. Section 1748.1 sought to fill the gap left by the short-lived federal ban, just like New York's law and the other state laws enacted around the same time. *See* Gupta Decl., Ex. D. It was intended, in other words, to forbid merchants from characterizing the cost of credit as a surcharge because that would (in the words of one credit-card lobbyist) "talk against the credit industry" and "make[] a negative statement about the card to the consumer." *Id.* Ex. B, at 60. But even if the law's own stated anti-deception purpose is taken at face value, that just shows that the law regulates speech. A surcharge "cannot simultaneously be non-communicative" and "yet pose the risk of *communicating* a misleading message." *BellSouth*, 542 F.3d at 510. Even the most charitable rationale for the law's ban on truthful, non-misleading surcharges (as expressed in a memorandum prepared in support of New York's ban) confirms that the law aims to suppress unwanted speech: "Surcharges, *even if only psychologically*, impose penalties on purchasers and may

actually dampen retail sales. A cash discount, on the other hand, operates as an incentive and *encourages desired behavior*." Gupta Decl., Ex. G (emphasis added).

A behavioral effect that "depend[s] on mental intermediation" just "demonstrates the power" of speech. *Am. Booksellers Ass'n, Inc. v. Hudnut*, 771 F.2d 323, 329 (7th Cir. 1985), *aff'd*, 475 U.S. 1001 (1986). The no-surcharge law affects consumer spending "only through the reactions it is assumed people will have to the free flow of [credit-card] price information." *Va. Bd. of Pharmacy*, 425 U.S. at 769. In the context of credit cards, this assumption is well placed: "Because of the framing effect, surcharges are far more effective than discounts at signaling to consumers the relative costs of a payment system." Levitin, *Priceless?*, 55 UCLA L. Rev. at 1352.

States, however, may not pass laws that seek to "diminish the effectiveness" of communication because the state has determined that certain speech is too powerful. *Sorrell*, 131 S. Ct. at 2663. "Those who seek to censor or burden free expression often assert that disfavored speech has adverse effects," *id.* at 2670, so courts must "be especially skeptical of regulations that seek to keep people in the dark for what the government perceives to be their own good," 44 *Liquormart, Inc. v. Rhode Island*, 517 U.S. 484, 503 (1996) (plurality op.). Fear that "the public will respond 'irrationally' to the truth" or "would make bad decisions if given truthful information" is no justification for a speech ban. *Id.* It is for "the speaker and the audience, not the government, [to] assess the value of the information provided." *Edenfield v. Fane*, 507 U.S. 761, 767 (1993).

Because the "purpose and practical effect" of section 1748.1 are to impose restrictions that turn on the content of a speaker's words, the First Amendment "requires heightened scrutiny." *Sorrell*, 131 S. Ct. at 2663–64. And because the law cannot survive scrutiny even if subject to a "special commercial speech inquiry," *id.*—that is, even under "pre-*Sorrell*, arguably more government-friendly, precedent"—this Court can "defer extended discussion of *Sorrell* for a more appropriate case." *Valle del Sol Inc. v. Whiting*, 709 F.3d 808, 821 (9th Cir. 2013).

B. The no-surcharge law fails heightened scrutiny.

Commercial speech is traditionally subject to intermediate scrutiny under the *Central Hudson* test, which asks four questions: (1) whether the speech "concern[s] lawful activity and [is] not . . . misleading"; (2) "whether the asserted governmental interest" justifying the regulation "is substantial"; (3) "whether the regulation directly advances the governmental interest asserted"; and (4) whether the regulation is "more extensive than is necessary to serve that interest." 447 U.S. at 566.

Courts "must review the [state's law] with 'special care,' mindful that speech prohibitions of this type rarely survive constitutional review." *44 Liquormart*, 517 U.S. at 504. "The party seeking to uphold a restriction on commercial speech carries the burden of justifying it." *Bolger v. Youngs Drug Prods. Corp.*, 463 U.S. 60, 71 n.20 (1983). This burden is "heavy," requiring actual evidence, not speculation and conjecture, that each *Central Hudson* factor is satisfied. *44 Liquormart*, 517 U.S. at 516; *see Edenfield*, 507 U.S. at 770–71; *Valley Broad. Co. v. United States*, 107 F.3d 1328, 1331 (9th Cir. 1997) ("The government's burden 'is not satisfied by mere speculation or conjecture.'"). The state cannot carry its burden here.

1. Dual pricing is legal, and calling the price difference a credit-card "surcharge" is not inherently misleading.

The speech restricted by section 1748.1 concerns lawful activity and is non-misleading. As Judge Rakoff explained in *Expressions*, "the regulated speech pertains solely to dual pricing, which all parties agree is lawful in itself." 975 F. Supp. 2d at 446. So too here. And there is nothing misleading about the message the plaintiffs want to communicate. Quite the contrary: A sign that prominently tells customers that "all credit card transactions are subject to a 3% surcharge" seeks to inform them about the cost of credit, not mislead them. *Id.* ("[The Court finds nothing

'inherently misleading' about a seller describing a price difference as a credit-card 'surcharge.'"). The state cannot possibly satisfy the first prong of *Central Hudson*.

2. The state has no legitimate interest in obscuring the cost of credit from consumers, nor is any legitimate state interest directly advanced by the no-surcharge law.

Nor can the state satisfy the second or third prongs. The law says that it seeks to "protect consumers from deceptive price increases for goods and services by prohibiting credit card surcharges and encouraging the availability of [cash] discounts." Cal. Civ. Code § 1748.1(e). But by preventing merchants from framing the cost of credit as a surcharge, the statue does not directly advance this interest (or any legitimate state interest). In fact, it *undermines*, rather than furthers, informed consumer decision-making—the very interest that the commercial-speech doctrine is designed to protect. The Supreme Court extended First Amendment protection to commercial speech because it recognized a "public interest" in the "free flow of commercial information" to foster "intelligent and well informed" economic decisions by consumers, specifically with respect to "price information." *Va. Bd. of Pharmacy*, 425 U.S. at 765. When a merchant uses a dual-pricing system, as Stonecrest does, a consumer can reduce the final price paid by paying in cash. Yet the no-surcharge law prohibits the merchant from telling consumers that they will incur an added cost for using credit. "It would be perverse to conclude that a statute that keeps consumers in the dark about avoidable additional costs somehow 'directly advances' the goal of consumer deception." *Expressions*, 975 F. Supp. 2d at 446.

The state's self-serving exemptions further defeat any interest that it might claim in preventing deception or otherwise protecting consumers. Tellingly, California exempts *itself* from the law: "Notwithstanding [the no-surcharge law], a court, city, county, city and county, or any other public agency may impose a fee for the use of a credit . . . card"—an odd carve-out if the law were really about deception. Cal. Gov. Code § 6159 (h); *see also* Cal. Code Civ. Proc.

§ 1010.5 (permitting California state courts to impose credit-card surcharges on fax filings); Cal. Food & Agr. Code § 31255(b) (permitting state animal-control officers to impose credit-card surcharges). And the no-surcharge law, by its own terms, "does not apply to charges for payment by credit card or debit card that are made by an electrical, gas, or water corporation and approved by the Public Utilities Commission." Cal. Civ. Code § 1748.1(f).

What interests do these exemptions further, exactly? "*Central Hudson* requires a logical connection between the interest a law limiting commercial speech advances and the exceptions a law makes to its own application." *Valle del Sol*, 709 F.3d at 824 (internal quotation marks omitted). What's that connection here? Why is the *government* permitted to frame the cost of credit as a surcharge when accepting payment for taxes, parking tickets, and water bills, for example, but a private merchant is barred from doing the same? *See, e.g.*, State of California Franchise Tax Board, Pay By Credit Card for Individuals, *available at* http://bit.ly/1l820Et (imposing a "convenience fee" of "2.3% of the tax amount charged" to use a credit card); City & County of San Francisco, Property Tax Payments, *available at* http://bit.ly/1yCUMIQ (imposing a "convenience fee of 2.25% for credit card payments" of property taxes); City of Huntington Beach, Make a Payment, *available at* http://bit.ly/XlHXre (imposing a "$3 convenience fee for paying [parking tickets] by credit card"); San Francisco Public Utilities Commission, Payment Options, *available at* http://bit.ly/1BiD5CD ("Credit card payments [of public-utility bills] will incur an additional charge of $5.80.").

These "exemptions and inconsistencies bring into question the purpose of the labeling ban." *Rubin v. Coors Brewing Co.*, 514 U.S. 476, 489 (1995). California can "present[] no convincing reason for pegging its speech ban to the identity" of the speaker, allowing certain favored entities to use the "surcharge" label but not others. *Greater New Orleans Broad. Ass'n, Inc. v. United States*, 527 U.S. 173, 191 (1999); *see Expressions*, 975 F. Supp. 2d at 447 ("Defendants offer

no explanation for why credit-card surcharges are somehow less deceptive when imposed by the Water Board, for example, than when imposed by ordinary commercial retailers like the plaintiffs."); *Valley Broad.*, 107 F.3d at 1334–36 & n.9 (holding that a state law's "myriad exceptions precludes [it] from directly advancing the government's purported interest" under *Central Hudson*, and declaring the law unconstitutional without even "reach[ing] the final prong").

3. The no-surcharge law is far more extensive than necessary to serve any legitimate state interest.

The state fares no better under the fourth (and final) *Central Hudson* prong—whether the law is broader than necessary to serve the interest identified by the state. For any legitimate purpose the state might identify, there are "numerous and obvious less-burdensome alternatives to the restriction on commercial speech." *City of Cincinnati v. Discovery Network, Inc.*, 507 U.S. 410, 417 n.13 (1993); *see Capital Leasing of Ohio, Inc. v. Columbus Mun. Airport Auth.*, 13 F. Supp. 2d 640, 669 (S.D. Ohio 1998) (explaining that "the prohibition against the use of words which could be used to present the information about the surcharge in an accurate and non-misleading manner [is] broader than necessary to prevent the description from being potentially misleading" or to prevent bait-and-switch tactics).

If the state's concern here is that surcharges should be adequately disclosed—as section 1748.1's statement of purpose suggests—then it could enact a law mandating adequate disclosure, just like Minnesota's law. *See* Minn. Stat. § 325G.051(1)(a) (allowing merchants to "impose a surcharge on a purchaser who elects to use a credit card" so long as the merchant "informs the purchaser of the surcharge both orally at the time of sale and by a sign conspicuously posted on the seller's premises"); *Expressions*, 975 F. Supp. 2d at 447 (discussing Minnesota statute). And if the state's concern is "gouging"—imposing surcharges that greatly exceed the swipe fees the merchant incurs—then the state could cap the amount of each

surcharge, just as the new credit-card-company rules limit surcharges to the cost of acceptance. *See Payment Card Interchange*, 2013 WL 6510737, at *21. Or the state could address these concerns (disclosure and gouging) simply by enforcing its own preexisting law, which broadly prohibits "any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising." Cal. Bus. & Prof. Code § 17200; *see also id.* § 17500 (prohibiting false advertising); *BellSouth*, 542 F.3d at 508 ("Even granting the Commonwealth's assumption that [consumer deception] was a potential problem, . . . why not first enforce existing state law on the point?").

But what the state cannot do is what it did here: ban an entire category of speech because some of it has the potential to mislead. *Peel v. Attorney Registration & Disciplinary Comm'n of Ill.*, 496 U.S. 91, 109 (1990). "If the First Amendment means anything, it means that regulating speech must be a last—not first—resort." *Thompson v. W. States Med. Ctr.*, 535 U.S. 357, 373 (2002).

II. California's No-Surcharge Law Is Impermissibly Vague.

The no-surcharge law is also too vague. Any law that "fail[s] to give persons of ordinary intelligence adequate notice of what conduct is proscribed" or that "permit[s] or authorize[s] 'arbitrary and discriminatory enforcement'" is impermissibly vague and violates due process. *G.K. Ltd. Travel v. City of Lake Oswego*, 436 F.3d 1064, 1084 (9th Cir. 2006) (quoting *Hill v. Colorado*, 530 U.S. 703, 732 (2000)). These "vagueness concerns are more acute when a law implicates First Amendment rights and, therefore, vagueness scrutiny is more stringent." *Id.* Section 1748.1 cannot survive that scrutiny.

As discussed, the law prevents a merchant from saying that it charges *more* for credit but not that it charges *less* for everything else. But who can say, for example, which of the following hypothetical signs would be legal?

- "If you pay by cash/debit, the cost is 2% less than if you pay by credit card."
- "If you pay by credit card, the cost is 2% more than if you pay by cash/debit."
- "Our posted prices reflect a 2% discount for cash/debit. Credit card users do not get the discount."
- "Cash/debit price (with discount): $100. Credit price: $102. We offer a $2 cash/debit discount."
- "Cash/debit price: $100. Credit price (with surcharge): $102. We impose a $2 credit surcharge."

How are merchants supposed to know which of these signs would violate the statute?

Courts have recognized the difficulty in answering these questions. *See Payment Card Interchange*, 2013 WL 6510737, at *19 ("No-surcharge laws are not only anti-consumer, they are arguably irrational."); *Expressions*, 975 F. Supp. 2d at 435 ("*Alice in Wonderland* has nothing on [New York's no-surcharge law]."). A California appellate court, in trying to decipher the scope of section 1748.1, sensibly refused to interpret it as covering a gas station that prominently disclosed two prices for gas—a "cash" price and a "credit" price—while saying nothing else. *Thrifty Oil*, 91 Cal. App. 4th at 1077. "To conclude otherwise in this case," the court reasoned, "would mean that every two-tier pricing system includes an unlawful surcharge on the customer who pays by credit card, a conclusion that would be wholly inconsistent with . . . [allowing] discounts by retailers who wish to offer a lower price for cash purchases." *Id.* The court explained that its construction was necessary to avoid "mischief or absurdity." *Id.*

That seems fair enough, but what if a customer had asked the gas station for its prices, and the cashier responded by saying that credit costs "extra" or "more"? What result then? Under New York's identical no-surcharge law, that speech would be unlawful. *See Fulvio*, 517 N.Y.S.2d at 1010, 1014. As a New York court observed after a gas-station owner was prosecuted for how his cashier described prices to customers:

> [W]hat [the no-surcharge law] *permits* is a price differential, in that so long as that differential is characterized as a discount for payment by cash, it is legally permissible; what [the no-surcharge law] *prohibits* is a price differential, in that so long as that differential is characterized as an additional charge for payment by use of a credit card, it is legally impermissible. . . . [The law] creates a distinction without a difference; **it is not the *act* which is outlawed, but the *word* given that act.**

Id. at 1015 (bold added; italics in original). The court found the law's vagueness "intolerable." *Id.*; *see also Expressions*, 975 F. Supp. 2d at 448 (explaining that "the Court has little difficulty concluding" that New York's no-surcharge law is "impermissibly vague").

Is California's law different? If so, what explains the difference? How can two indistinguishable state laws have two different meanings? And if they do, then what does section 1748.1 prohibit? And how is a merchant like Stonecrest, which uses a dual-pricing system, to know? What can it look to when trying to communicate its prices to customers? What about those charged with enforcement of the law? What standards should they use, and where do they come from? That none of these questions can be answered with any confidence, let alone by the clear text of the statute, is proof enough of its vagueness.

CONCLUSION

This Court should enter an order granting the plaintiffs' motion for summary judgment, declaring California's no-surcharge statute unconstitutional, and permanently enjoining the Attorney General (or any other person acting in the name of the State of California) from enforcing the no-surcharge statute.

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Respectfully submitted,

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