IN THE UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF CALIFORNIA

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BEFORE THE HONORABLE MORRISON C. ENGLAND, JR., CHIEF JUDGE

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ITALIAN COLORS RESTAURANT, et al.,

Plaintiffs,

No. 2:14-cv-00604

vs.

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

Defendants.

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REPORTER'S TRANSCRIPT

MOTION HEARING

THURSDAY, DECEMBER 18, 2014

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Reported by: DIANE J. SHEPARD, CSR 6331, RPR

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SACRAMENTO, CALIFORNIA

THURSDAY, DECEMBER 18, 2014

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THE CLERK: Calling case 14-604, Italian Colors Restaurant, et al., v. Kamala Harris. On for plaintiffs' motion for summary judgment, defendant's motion for summary judgment, and defendant's motion for change of venue, Your Honor.

THE COURT: Appearances, please.

MR. GUPTA: Good afternoon, Your Honor. Deepak Gupta for the plaintiffs.

THE COURT: Good afternoon.

MR. HAKL: Good morning, Your Honor. Anthony Hakl, Deputy Attorney General, on behalf of the defendant, the Attorney General.

THE COURT: Thank you.

First thing, with respect to the motion for change of venue?

MR. HAKL: That is actually -- we just briefly conferred. That is an error on the Court's calendar. I believe the docket item, number 24 on that, is a motion to file an amicus brief.

THE COURT: Since it was raised and it was on the calendar, I wanted to raise it here to make sure if it's out, it's out. There is no such motion?

MR. HAKL: There is no motion to change venue, Your Honor.

THE COURT: Thank you. I'll have that corrected on the calendar.

This is a motion for summary judgment. I've reviewed the moving papers that have been filed in this action by both sides, and this is centering around the California Civil Code Section 1748.1, specifically subsection A, which does read in part that: 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.

This is somewhat of an interesting case. It's been around for a while, the particular statutory language that California has, and it was on the books for quite some time with the Federal Government, but that law was allowed to lapse by Congress, and then California came in and drafted its own legislation regarding this.

And I think the case that is looked to and within the State of California would be the Thrifty Oil case, which is the only one that I think that's actually dealt with the particular

issues at hand, and it does permit the dual-pricing system to charge more than normal prices under Thrifty Oil.

But the issue comes down to whether or not the plaintiffs can call the use of that fee a surcharge versus a discount, and it gets into somewhat of semantics which way you go, but I understand also, from the plaintiffs' perspective, that there is a certain level of the way that the consumer will view things that are either a surcharge versus a discount, and by saying that it's a discount or it's a surcharge, it might show that that $102 item that really cost $100, you're being charged for the fee, and that's what you would like to be able to do through I believe it's First Amendment theories that this is speech only.

So I'll let you give me a five-minute overview of where you want to go from there. I just wanted to make sure that we're all on the same page right now.

MR. GUPTA: Thank you, Your Honor. That's helpful. There is nothing that you just said that we disagree with.

Let me just address, briefly, why we're here even though the statute was enacted in 1985 because that might be surprising.

And the reason is that these statutes sort of were in the background. They lurked in the background because the credit card companies had parallel speech bans in their contracts with merchants, and it was only last year through

national anti-trust class action settlements that the credit card companies, Visa, Mastercard and American Express, have now agreed to drop those contractual restraints on framing the price difference as a surcharge as opposed to a discount.

And so now these state laws that have been sitting in the background suddenly leaped to the forefront. They now are the only thing standing in the way of the merchants in effect taking advantage of the relief that they've won under those settlements.

You said, Your Honor, that it may seem like semantics, but it matters to us. The fact that the law turns on semantics is something that every judge that has looked at the constitutionality of these surcharge statutes, that central insight is one that's shared among those courts.

And the most comprehensive decision that we think is on all fours with this case is the case -- the Expressions case from New York, Judge Rakoff's decision. And Judge Rakoff dealt with New York's statute, which is indistinguishable. I don't think there is any disagreement between the parties that the New York statute is effectively the same thing as the California statute. It prohibits surcharges but permits discounts.

And Judge Rakoff struck down the New York statute just recently on First Amendment and vagueness grounds, and we really couldn't say it better than Judge Rakoff has said, and

so I think really the question before you is whether or not to follow Judge Rakoff or to depart from his analysis.

The only decision that has departed from Judge Rakoff's analysis is a recent decision in the Northern District of Florida dealing with Florida's indistinguishable surcharge statute. And that decision -- it's a short decision, not as comprehensive as Judge Rakoff's -- but we think it gets it partly right and partly wrong.

What it gets partly right is that the law turns on nothing but semantics. The law makes it illegal to frame the identical mathematically equivalent price difference as a surcharge, but makes it permissible to frame it as a discount. And as the judge there said, that means that it's not really -- the law doesn't really turn on economics. It turns on semantics. So that part I think the judge got right.

What the judge got wrong was the next step of the analysis. He then said that the statute is, nevertheless, subject to only rational-basis scrutiny. Once you conclude that a statute turns on nothing but semantics, that's a conclusion that the statute is a content-based restriction on speech. And so, as Judge Rakoff held, it's subject to heightened scrutiny.

Now, the Supreme Court has been --

THE COURT: That's the issue that's coming up then is whether or not this is regulating economic activity or it

isn't.

MR. GUPTA: Right.

THE COURT: And so I understand that's the issue that you're coming up with.

MR. GUPTA: Right.

THE COURT: It's either rational basis or intermediate scrutiny.

MR. GUPTA: Right.

THE COURT: Depending on how you couch it.

MR. GUPTA: But there is no such thing as rational-basis scrutiny under the First Amendment for a commercial restriction simply because it regulates economics.

Once you make the conclusion that the statute turns on semantics, the analysis then should be that, okay, yes, there is some economic relevance to this speech, but it's speech nevertheless. And so it's subject, at a minimum, to the Central Hudson standard, which is the standard that Judge Rakoff used in the Expressions case. It's a content-based restriction on speech.

And you then ask the state to justify its restriction, and the state has to identify an interest, explain whether the statute directly advances that interest, and explain whether it's less restrictive than other ways of addressing that interest.

THE COURT: But if you look at it and say that the

widget costs $100, but when I get you to the cash register and you hand me a Visa card, it's now $103, isn't that an action versus speech?

MR. GUPTA: I don't think so. I mean --

THE COURT: You're charging because there is a certain level of cost associated with using a credit card as opposed to cash or a debit card, for example.

MR. GUPTA: We don't deny that charging something to the consumer and the consumer paying, that that's an economic transaction. Of course it is. And that is conduct. And so if a consumer pays $100 for a widget, that transaction between the merchant and the consumer is conduct. But the transaction is the same here whether it's framed as a surcharge or a discount. In other words, if I pay $3 more for cash for using -- sorry -- $3 less for using cash or $3 more for using a credit card, either way I'm still paying the same amount. The only thing that's different is the way it's being communicated to the consumer.

And no court that's analyzed the constitutionality of the statute has rejected that sort of basic common-sense proposition. In fact, the earliest reported case under any of these surcharge statutes was a case in New York, the Fulvio case, where you had a gas station -- it's sort of like the situation you described, Your Honor, in Thrifty Oil, where you had a gas station that was describing both a cash price and a

credit price, but then the cashier at the gas station made the mistake of telling a customer that it was a nickel more for using credit. It would have been fine if she had said it was a nickel less for using cash.

But either way, the consumer is paying the same amount so the economic transaction is precisely the same. And that's why Judge Rakoff said this whole statute turns on this virtually incomprehensible distinction between what a merchant can and cannot tell its consumers.

And once you make that conclusion, the burden then shifts to the State to justify the law under Central Hudson, which is not an unusual burden. Lots of statutes regulate commercial speech, the Truth and Lending Act, the Fair Debt Collection Practices Act, and those statutes would easily pass muster because the State would have good reasons for justifying its restrictions on speech. So it's not an unusual thing to take the step of saying that this is subject to Central Hudson scrutiny.

The problem here for the State is it's not really attempting to justify the law under Central Hudson. It's put all of its eggs in this speech-versus-conduct basket. And once you get to the Central analysis -- Central Hudson analysis, as Judge Rakoff did, there really isn't much to say for the statute. It does not actually serve an interest in preventing deception.

We have no problem with a requirement like Minnesota's, which says you can have a surcharge, you can have a discount, you can frame it however you want, but no matter what you do, you've got to disclose that to the consumer.

That kind of disclosure regime would be perfectly permissible, and it shows that if the State's interest really is in avoiding bait and switch or deception, then it has much narrower ways of doing that. And for that reason alone, the statute should fail Central Hudson scrutiny.

THE COURT: That's a perfect segue for me because that's what I would like to get to from the State's standpoint.

It's ok to say that I can give you a discount, but I can't give you a surcharge. If the true intent is to provide for a buffer from, as we've called it, bait-and-switch techniques, why not just say this is what the cost is if you use a credit card, and here's what the cost is if you use cash, and let the consumer understand that there are certain fees associated with using a credit card that have to be passed along, or can be passed along, or are being passed along versus just having cash money. Why is there such a distinction between the two?

MR. HAKL: Well, Thrifty Oil tells us that I think what the Court was just referring to is permissible.

THE COURT: That's Thrifty, to a certain extent, but it's moved on a little bit since then.

MR. HAKL: And to the extent that -- there seems to be some focus on the use of the word surcharge, and to the extent that a retailer may not be able to use the word surcharge, that's not because the statute says you can't say surcharge. I mean what the statute does is regulates what you can do - add a surcharge or offer a discount.

And if I were to point the Court to one case, I think, that we cited in our briefs that kind of goes through the analysis as we see it, it's the First Circuit case, the National Association of Tobacco Outlets case.

And the court there gets to this issue at page 77 where they -- the ordinance there was a tobacco pricing law -- and it said, the ordinance here does not restrict the dissemination of pricing information generally. That's the same thing here. This does not concern the dissemination of pricing information generally.

And in the First Circuit case, nothing in the price ordinance there restricts retailers or anyone else from communicating pricing information. You can convey the pricing information. Rather it restricts the ability of retailers to engage in a certain pricing practice, which is the same thing here. The pricing practice here is adding a surcharge.

And then also, the law barred retailers from offering to engage in those prohibited pricing practices.

So what the law -- you can't -- because surcharges

are unlawful you can't offer to engage in a transaction that involves adding a surcharge.

So to the extent you can't say surcharge, it's not because the law tells you how you can communicate. It's because the law makes surcharges unlawful, and unlawful transactions are not protected by the First Amendment. We know that from cases like the First Circuit case and Central Hudson. So I think that's the key to the analysis there.

And Your Honor is correct, we don't see this as a First Amendment case. It doesn't concern speech. It concerns economic activity that's well within California's police powers to regulate and legislate.

And if I may, I don't want to look past the standing arguments that we have, Your Honor, because I think they are strong and they are valid. It occurred to me that -- you mentioned that the statute is around since 1985. And there have been virtually -- the only enforcement action that either side has been able to identify is this Thrifty Oil case.

In contrast, in New York, even though these clauses were there contractually, as has been referenced, the Fulvio case was there in 1987, I believe. I think it was 1987. If you look at the Expressions Hair Design case, it talks about a few more published cases, sweeps that the Attorney General's Office had done in New York to enforce the law.

And, here, even though there is a First -- you know,

a First Amendment allegation, it's not -- there is no genuine threat of prosecution that has been shown. And one reason for that -- I mean another distinction between the New York and California law is the New York law provides for criminal penalties, and it also lacked a scienter requirement.

Whereas, the California statute, it only allows for civil enforcement. There is no criminal penalties involved. You don't even come within the purview of the statute until, I think, subsection B requires a willful violation. So this idea that you might accidently stumble into this by somehow misspeaking is not borne out by the context -- by the language of the statute.

If you look at Judge Rakoff's opinion, when he gets to the vagueness analysis, one of the things that he looks at when he talks about vagueness is it's criminal. So the vagueness standards, you know, are a little bit tighter. And there is no scienter requirement, so there is no sort of safe harbor in case someone stumbles into it.

Here, the California law, it's civil enforcement. It provides for a small claims action, and it requires a willful violation. So to get to this point where there is no distinctions between the New York statute and the California statute, there are differences.

THE COURT: I was not trying to go over standing, but it seems to me that it's either going to be an economic statute

or it's First Amendment. Because if it's simply First Amendment, then plaintiffs have the right to be here if it's a First Amendment constitutional violation. On the other hand, if the Court finds that it is not First Amendment and strictly an economic act on the part of the State of California, which has the power to do that, and there has not been any damage suffered by the plaintiffs at this time, then I think we have a real issue on standing. So I'm very clear on where that goes. It's going to really turn on this issue.

MR. HAKL: If you see this as a true First Amendment challenge that implicates speech, it would still be a pre-enforcement First Amendment challenge. And even in that scenario, you would still have to show a genuine threat of prosecution.

And in our briefs we lay out the things to consider in that regard - a history of enforcement of the statute, whether you've been threatened by the authorities.

And, here, you wouldn't even have a threat from the authorities necessarily. I mean, the most likely, under the language of the statute, it would be from a customer, but that's not even in the declarations. I don't even think the declarations say that there's been a customer complaint, for example.

It's just that in an effort to couch this as a First Amendment claim, it's we want to talk to our customers this

way, and we can't. That's the extent of the injury as claimed.

So I just didn't want to shoot past any of the standing Article III requirements. But if you do get past that, we agree. I mean, the first question is, is it economic conduct, is it a pricing practice, or is it speech? And then if you think it's speech, then you're confronted with Central Hudson, and we do address that in our briefs, and we think that that's satisfied.

THE COURT: Your response?

MR. GUPTA: Well, I want to make one thing clear. I think the standing inquiry shouldn't become a referendum on the merits, right. I think the Supreme Court's been pretty clear about that. We have certainly asserted a First Amendment claim. I understand that they have a response on the merits, but for purposes of the standing inquiry, I think you have to assume that we have a valid First Amendment claim, and the question is whether we have the right to be in court to make that claim.

And Judge Rakoff also addressed the State's standing challenge in some depth. The plaintiffs here are situated in just the same way, and this is really a standard pre-enforcement First Amendment challenge.

The plaintiffs are being chilled, and that's the injury that they are alleging. I mean, Italian Colors, the lead plaintiff here, was the lead plaintiff in the anti-trust

class action against American Express. So they brought this case that went on for years. It went all the way to the Supreme Court. They finally won this relief to be able to frame the price difference as a surcharge, and the only thing standing in the way of Italian Colors' ability to do that is this State statute. So there really isn't any question that they've got a concrete interest that they fought hard to win, and that falls squarely within the Ninth Circuit's cases and the Supreme Court's cases about pre-enforcement First Amendment challenges.

So I hope that the suggestion that I'm hearing from my colleague, I hope that Your Honor wouldn't analyze this as sort of a way of doing a drive-by holding on whether we have a valid First Amendment claim. I think the standing analysis has to assume that we do have a valid First Amendment claim.

I want to just briefly address the First Circuit's decision in the Providence case that my friend mentioned. We don't have any problem with the First Circuit's analysis in that case. I think it's right. The First Circuit was analyzing a City of Providence law that was really classic price regulation of the kind that clearly doesn't fall within the First Amendment.

If a state or a city is capping the price on some product, that's, you know, actually restricting the price itself. We're not suggesting that that's something that falls

within the First Amendment. What you have here is an unusual statute, to be sure, but what it does is it does not change the price. The consumer pays precisely the same price. The only thing being regulated is the language that communicates price information.

And the Commercial Speech Doctrine is born out of precisely that kind of statute. The Virginia law that gave birth to the Commercial Speech Doctrine, the Virginia Board case, was a case that regulated communication of price information about drugs. That's why the Supreme Court created the doctrine.

And Judge Rakoff got this right also. He explains that there is a pretty critical distinction between regulating prices and regulating price information, which is subject to Central Hudson.

And, finally, let me just address what my colleague said about the criminal nature of the New York statute. As I read Judge Rakoff's First Amendment analysis, nothing turns in his First Amendment analysis on the fact that that statute had criminal penalties. I mean, that doesn't change the fact that both the California law and the New York law are statutes that regulate speech. They regulate the content of speech, and that's all that they regulate.

And it doesn't change the Central Hudson inquiry. The Supreme Court has never suggested that the Central Hudson

inquiry is somehow different on the civil side as opposed to the criminal side. It's true that it makes some difference for vagueness, but, you know, Judge Rakoff was quite convinced that this statute did not come close to satisfying Central Hudson or vagueness. I don't think that distinction really gets the State very far.

In all other respects, these are the same statute, and they have the same genesis. We are not here, many years after the statute was enacted, cooking up some kind of First Amendment problem with this statute. If you look at the history of the federal ban from which the California law originates, the lobbyists for the credit card industry were concerned that surcharges, in their words, talk against the credit card industry, that they make a negative statement about credit cards.

So they understood from the very beginning that what they were really getting at was the communicative impact of the surcharge label versus the discount label on consumers. That's been true all along, and it's why the credit card companies are really the only ones that want this statute to exist, and consumer groups and merchant groups are all opposed to them.

THE COURT: All right. Do you have anything else that you would like to follow up on?

MR. HAKL: Only, again, with respect to the standing. I mean, in our reply brief we lay out the cases that talk about

-- I mean, just when you claim First Amendment that doesn't automatically give you standing.

You still need to -- under cases like ACLU versus Heller, 378 F.3d 979, and also the Thomas case, 220 F.3d 1134, some generalized threat of prosecution isn't enough. You have to show a credible threat of enforcement, and there is no snowing of that here. Other than that --

THE COURT: Are you willing to stipulate that the State will not enforce the statute?

MR. HAKL: No. I mean -- right. I mean, I couldn't do that.

THE COURT: Right.

MR. HAKL: But it's important to note that what the statute authorizes is a civil action by a customer compared to what the New York statute does. It allows a D.A. or the Attorney General to file criminal charges. The same thing with Florida.

Now, can the Attorney General, as the chief law enforcement officer of the State, maybe someday pursue an unfair business practice case and try to enforce the surcharge law that way? Perhaps. And you know what, if that happens, then a party might have standing, but there is nobody with standing in this case now.

THE COURT: But if the Attorney General -- if plaintiffs now say, all right, we know we can say we'll give

you a three-percent discount, and effective tomorrow we're going to start telling everyone that we're giving a three-percent surcharge for every credit card swipe, and that went all across the State of California, would the Attorney General sit by and do nothing, or would the Attorney General bring some type of enforcement action?

MR. HAKL: I mean, I can't predict that. I don't know the answer to that.

THE COURT: Probably you would bring some type of enforcement action, especially if it was a chain of retail establishments. For example, Home Depot or Walmart says effective December 19th every credit card transaction will be subject to a three-percent surcharge.

I can't imagine that the Attorney General would just allow that to happen within the State of California at a retail merchant the size of Walmart, or Home Depot, or Target, or wherever it would be.

MR. HAKL: I understand that, and that's certainly a reasonable assertion. And if that were the case, then there would be a case for controversy, but that hasn't happened. That's all. That's my only point.

THE COURT: All right.

MR. HAKL: Other than that --

THE COURT: I'm going to take it under submission. I'm going to rule on the motions that you have today, but I

will say that the written order will supersede any comments or statements made by the Court during this oral argument. I just wanted to test some of the theories that were being said here.

Do you have any final response?

MR. GUPTA: I'll just be very brief on standing, Your Honor. I just wanted to mention that the Thomas case from the Ninth Circuit is not a case about chilling. There was no allegation that the plaintiffs there were being chilled.

And I think your question really says it all. The State is unwilling to say that it won't come after my clients tomorrow, and that's really all that you need to know for standing. Thank you.

THE COURT: All right. There were some objections that were filed by the defendant in this case. The first was to the selective and incomplete transcript. I think that was Exhibit B. Defendant cites to Federal Rule of Evidence 106. I think the issue is whether or not it should be a part of a writing.

Rule 106 entitles the defendant to introduce the entire writing but not to exclude a partial writing. Therefore, that objection is overruled.

Second motion was regarding relevance, prejudice, hearsay. I think the general issues that one would come up. And that would be, I think, more relevant if this were going to an actual jury trial, but this is actually a summary judgment,

so the Court can weigh the evidence that it believes and give it whatever weight it thinks it deserves at that time. So that would be overruled.

The next would be -- the third would be there was a brief that was filed, but there's been now an amicus brief that's actually been filed, so actually the objection is moot. So there is no reason for the Court to rule upon that at this time since they have been granted amicus status.

MR. HAKL: I would withdraw that anyway, Your Honor.

THE COURT: All right. If you wish to withdraw it, that's fine. That motion in limine will be withdrawn.

Exhibit G. It's an excerpt legislative history of the surcharge law. I think there may be some distinctions between that law and this law in California. The criminal aspect is one. I can give it the weight that I think it deserves, so for now I will overrule the objection for the purposes of summary judgment.

Anything else? If not, thank you. Very well argued, counsel. Thank you very much.

No other matters on the civil calendar, court will be adjourned.

(Court adjourned. 2:45 p.m.)

CERTIFICATION

I, Diane J. Shepard, certify that the foregoing is a correct transcript from the record of proceedings in the above-entitled matter.

/s/ DIANE J. SHEPARD
DIANE J. SHEPARD, CSR #6331, RPR
Official Court Reporter
United States District Court