NO. 15-1391

In the Supreme Court of the United States

EXPRESSIONS HAIR DESIGN, ET AL.,

Petitioners,

v.

ERIC T. SCHNEIDERMAN, ATTORNEY GENERAL OF THE STATE OF NEW YORK, ET AL.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF OF *AMICUS CURIAE* PROFESSOR ADAM J. LEVITIN IN SUPPORT OF PETITIONERS

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INTEREST OF *AMICUS CURIAE*[1]

Amicus curiae Adam J. Levitin is a Professor of Law at the Georgetown University Law Center. He previously served as the Bruce W. Nichols Visiting Professor of Law at Harvard Law School and on the Consumer Financial Protection Bureau's Consumer Advisory Board. Professor Levitin teaches courses in payment systems and consumer finance. He has also authored several scholarly articles regarding credit-card surcharges, including on the ways such surcharges influence consumer behavior, and on lawmaking efforts, undertaken at the behest of the credit-card industry, to prevent merchants from using surcharges.[2] His works have been cited by the petitioners in this Court, by both the challengers and the states in the Second, Fifth, and Eleventh Circuits, and by the courts

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[1] All parties have consented to the filing of this brief. No counsel for a party authored this brief in whole or in part, and no entity other than *amicus* or his counsel has made a monetary contribution to the preparation or submission of this brief.

[2] Adam J. Levitin, *Private Disordering? Payment Card Fraud Liability Rules*, 5 Brook. J. of Corp. Fin. & Comm. L. 1 (2010); Adam J. Levitin, *Cross-Routing: PIN and Signature Debit Interchangeability Under the Durbin Amendment*, 2 Lydian J. 16 (Dec. 2010); Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 UCLA L. Rev. 1321 (2008) (*Economic Costs*); Adam J. Levitin, *Priceless? The Social Costs of Credit Card Merchant Restraints*, 45 Harv. J. on Legis. 1 (2008) (*Social Costs*); Adam J. Levitin, *Payment Wars: The Merchant-Bank Struggle for Control of Consumer Payment Systems*, 12 Stan. J.L. Bus. & Fin. 425 (2007); Adam J. Levitin, *The Merchant-Bank Struggle for Control of Payment Systems*, 17 J. Fin. Transformation 73 (2006); 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 (2005).

themselves in those cases.

Amicus submits this brief to lend further support to the observations in the behavioral-economics scholars' *amicus* brief, which he adopts, and to offer the benefit of his own expertise concerning the specific behavioral dynamics and consumer-protection issues at play in credit-card surcharging. He takes no position on whether the merchant advertising practices at issue in this case constitute speech, or on whether laws limiting those practices violate the First Amendment.

SUMMARY OF THE ARGUMENT

It costs money to get paid. Merchants accept payments from consumers through a variety of methods: cash, checks, credit cards, debit cards, electronic benefit transfers, and automated clearing-house transfers. Each of these payment methods causes merchants to incur expenses, sometimes in the form of per-transaction "swipe fees," and sometimes in other ways. And some payment methods, such as credit cards, are significantly more expensive for merchants than others.

Like any other cost of doing business, merchants pass these costs of payment onto their customers, and some logically wish to impose these increased marginal costs solely on those customers who cause them to be incurred—by charging customers paying with credit a higher price than those paying in cash. All states allow such differential pricing, but some restrict how merchants may *describe* the differential price to their customers. Under the "no surcharge" laws in New York and several other states, merchants may offer "discounts" to consumers who pay with cash, but they are prohibited from imposing "surcharges" for credit-card payments (or in Connecticut for *any* non-cash form of payment, Conn. Gen. Stat. Ann. § 42-133ff(a)). Thus, in states with no-surcharge laws, a merchant could advertise a regular price of $100 and offer a $3 cash discount, but could not advertise a regular price of $97 with a $3 surcharge for credit—and in some states a merchant will face criminal penalties for characterizing the transaction incorrectly. *E.g.*, N.Y. Gen. Bus. Law § 518; Fla. Stat. § 501.0117(2).

It is not merely that these speech codes create traps for the unwary, however. Restricting merchants' word-choice matters because it deeply influences consumer behavior. Although discounts and surcharges are mathematically equivalent ways of representing the relationship between two prices, there are important behavioral and communicative distinctions between them that make it far more effective communication for merchants to call a price differential a surcharge than a discount. Not only does the surcharge label more accurately convey that using a credit card *costs more* than cash. But psychologically, consumers have strong negative reactions to surcharges, and only mild positive reactions to discounts. A surcharge thus communicates a much more powerful incentive. Other practical considerations might also cause merchants to prefer to characterize the price differential as a surcharge rather than a discount—for instance, unlike a surcharge, offering discounts requires merchants to raise their advertised base prices, which puts them at a competitive disadvantage to merchants offering no such discount. Such factors effectively force merchants in states with no-surcharge laws into offering "homogenized," single-tier pricing, irrespective of the consumer's method of payment. Accordingly, state no-surcharge laws effectively mute merchants' ability to communicate payment preferences to consumers.

States claim that no-surcharging laws are motivated by a desire to protect consumers from supposed surcharging abuses, but this claim is belied by the history behind such laws, which reveals them instead to be protectionist legislation for the credit-card industry dressed in the clothing of consumer protection. Worse, the supposed consumer concerns asserted to justify these laws are themselves minimal and speculative, which is amply illustrated by an examination of the sales practices in other countries where surcharges have long been permitted without particular controversy. And where true risks to consumers actually arise from surcharges, these are better addressed through narrower, more targeted laws.

Far from protecting consumers, the homogenized pricing that results from no-surcharge laws is actually harmful to many consumers' welfare. Homogenized pricing creates a regressive cross-subsidy from the generally less-affluent users of lower-cost payment systems to the generally more-affluent users of higher-cost payment systems. In its most extreme form, food-stamp consumers end up subsidizing first-class upgrades for users of rewards credit cards.

This cross-subsidy harms lower-income consumers by reducing their spending power, and even the corresponding benefits to usually more well-off credit-card users are limited. The subsidy encourages excessive use of credit cards, causing some credit-card users to incur unwarranted amounts of consumer debt. And when it comes to reward credit cards, which have significantly higher "swipe fees" even relative to other credit cards, the benefits are particularly attenuated, because less than half of the value gained through those higher fees is actually shared with card users themselves in the form of rewards benefits—the majority is retained by credit card companies. Indeed, credit-card companies are the true beneficiaries of no-surcharge laws, but states' desire to protect those companies' profits provides insufficient justification for silencing merchants' speech.

ARGUMENT

I. No-surcharge laws mute legitimate merchant efforts to transmit important price signals to consumers.

No-surcharge laws exploit a natural human cognitive bias: the tendency to view a discount as less meaningful than a surcharge. By forcing merchants to communicate with customers in this less-meaningful language, these laws interfere with the free flow of information, depriving customers of important facts about the true costs involved in providing them with goods and services, and disrupting the incentives that would otherwise encourage the use of lower-cost payment mechanisms. The results are artificially inflated costs for merchants and consumers, and artificially inflated profits for credit-card companies.

Payment systems are the essential infrastructure of the modern economy—the "plumbing" for all movements of value in transactions. Merchants can offer a wide variety of payment mechanisms to facilitate customers' purchases, including cash, check, automated clearing-house (ACH) transfers, PIN-debit cards, signature-debit cards,[3]

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[3] Debit cards differ from credit cards in that all debit card payments draw upon funds in a consumer's deposit account. There are also different types of debit cards. A "PIN-debit" or "single-message" card allows a customer to authorize payment by inputting a PIN number,

and credit cards. None of these payment mechanisms is free, and the costs of some are quite high. A study done in 2000 calculated that for a $100 transaction, it costs merchants an average of $0.90 to accept cash, whereas a PIN-debit transaction would cost $0.80 cents, a check $0.80 cents, an automated clearing-house payment $1.00, and a signature-debit card or credit card $1.80. Humphrey, note 3, *supra*, at 163. These disparities have only increased over the last 16 years as the cost of accepting credit card and signature-debit cards has gone up, *see* Robin Prager et al., Fed. Reserve Bd., Div. of Research & Statistics & Monetary Affairs, *Interchange Fees and Payment Card Networks Economics, Industry Developments, and Policy* Issues 75, fig. 3 (2009), <bit.ly/2f8peHS>, while the cost of accepting most PIN-debit cards has gone down as the result of regulatory caps, 15 U.S.C. § 1693o-2; 12 C.F.R. § 235.3(b).[4] Moreover, there can be significant cost differentials even within particular payment methods. For

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and the funds transfer goes through a regional ATM network. A holder of a "signature-debit" or "dual-message" card authorizes payment with a signature, like a credit card, and the funds transfer goes through MasterCard's or Visa's network. The cost structures of PIN-debit and signature-debit are also different—with swipe fees for signature-debit cards (which are not regulated under the Durbin Interchange Amendment, codified at 15 U.S.C. § 1693o-2) closer to those of credit cards. *See* Bd. of Govs. of the Fed. Reserve Sys., *Average Debit Card Interchange Fee by Payment Card Network*, <bit.ly/2fQqCk8> (reporting that the average unregulated signature-debit fee is 1.39% of transaction value, compared to 0.65% for PIN-debit); David Humphrey et al., *What does it Cost to Make a Payment?*, 2 Rev. of Network Econ. 159, 163 (2003), <bit.ly/2fKVum5> (reporting that average credit card swipe fees are 1.8% of transaction value).

[4] The major exclusion is for debit cards issued by banks with less than $10 billion in assets. 12 C.F.R. § 235.5(a)(1).

instance, among credit cards, which are already the most expensive consumer payment method, those with rewards programs are far more expensive than those without rewards—largely because of the additional cost associated with the bundled rewards program.

Although the cost differences may be relatively small for individual transactions, when the fees assessed on each of the transactions taking place in the United States are aggregated, the differences amount to tens of billions of dollars annually. Indeed, the cost of accepting payment is one of the largest (and fastest growing) operating costs for American merchants, Merchants Payments Coalition, *Reforming Credit Card Swipe Fees to Grow Our Economy* 2 (2015) (*Reforming Card Swipe Fees*), <bit.ly/2fae2Ox>, a factor that reduces American merchants' competitiveness relative to merchants in foreign nations that allow surcharges.[5]

Given the cost differences among payment instruments, merchants logically desire to incentivize the use of cheaper payment instruments, *ceteris paribus*, and the

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[5] Credit-card surcharges have been permitted for over a decade in Australia, Israel, the Netherlands, Sweden, Switzerland, and the United Kingdom, Fumiko Hayashi & Jesse L. Maniff, Fed. Reserve Bank of Kansas City, *Public Authority Involvement in Payment Card Markets: Various Countries* (Aug. 2016) (*Public Auth. Involvement*), <bit.ly/2g4jMe0>, and are also permitted in seventeen of the twenty-seven European Nation member states under Article 52(3) of Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on Payment Services, *see* Tipik Commc'ns Agency, *Directive 2007/64/EC – General Report on the Transposition by the Member States* 42 (Aug. 2011), <bit.ly/2g3cS4Y>.

most natural way for them to do so is through price signals. The price theory of demand—the idea that levels of demand respond to price signals—is the most basic building block of economics. *See, e.g.*, Adam J. Levitin et. al., *The Dodd-Frank Act and Housing Finance: Can It Restore Private Risk Capital to the Securitization Market?* 29 Yale J. on Reg. 155, 165 (2012). In other words, price is a language customers understand. Accordingly, merchants communicate information to their customers through the ways they frame the prices they charge, as well as through the kinds of services *for which* they charge. By adding a surcharge for credit, merchants can clearly communicate the marginal cost of using a credit card to their customers, and express their desire for customers to use cheaper payment mechanisms.

No-surcharge laws restrict merchants' ability to communicate these increased costs—and their preference for minimizing those costs—through price signals.[6] By permitting merchants to describe differential prices only in

[6] Credit-card companies also include restrictions against surcharges in the terms they impose upon merchants seeking access to their payment networks. These network restrictions have been challenged as violating antitrust laws, *see United States v. Am. Express Co.*, 838 F.3d 179 (2d Cir. 2016); *In re Payment Card Interchange Fee & Merch. Disc. Antitrust Litig.*, 827 F.3d 223 (2d Cir. 2016) (*Payment Antitrust Litig.*), and have been invalidated by competition authorities in a number of countries, *see generally Public Auth. Involvement*, note 5, *supra*.

In the U.S., however, no-surcharge laws have proven to be an obstacle to resolution of these anti-trust actions. Several credit card companies have entered into settlements whereby they have agreed to refrain from enforcing their private surcharge rules, but courts have invalidated these settlements as illusory on the theory that merchants terms of cash discounts, not credit-card surcharges, these laws purposefully mute the signals that merchants can send to customers. (Pet. Br. 14)

This is because a surcharge and a discount may be *mathematically* equivalent ways of representing the relationship between two prices, but they nevertheless have very different effects on consumer behavior. Whichever price is presented as the "base" price—from which the surcharged or discounted price deviates—creates an anchor or frame for consumer evaluation of the price relationship. Cognitive psychologists and behavioral economists have shown that these frames shape consumers' perceptions. Just as whether a person's perception can be shaped by describing a bottle as half-full or half-empty, scientists have shown that consumers react differently when a price differential is described as a surcharge than when it is described as a discount. Consumers have a strong negative reaction to a credit-card surcharge, but only a mild positive reaction to a mathematically equivalent cash discount. *See* E. Vis & J. Toth, ITM Research, *The Abolition of the No-Discrimination Rule, Report for European Commission Directorate General Competition* 11 (2000), <bit.ly/2g4QTM9>; *see also* Scott Schuh et al., *An Economic Analysis of the 2010 Proposed Settlement Between the Department of Justice and Credit Card Networks* 26-27 (Fed. Reserve Bank of Boston, Public Policy Discussion Paper No. 11-4, 2011), <bit.ly/2fGYFOc> (discussing an IKEA internal study finding that surcharging results in decreased use of credit cards). This means that the mildly positive consumer reaction associated with a

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would still be barred from charging surcharges under state law. *E.g.*, *Payment Antitrust Litig.*, 827 F.3d at 238.

discount will not incentivize consumers to choose cheaper payment methods in the same way that the strongly negative signal of a surcharge would, a cognitive bias that introduces inefficiency that artificially inflates the costs that customers are willing to accept for the good or service. In simple terms, if consumers don't know the price of a service, they are likely to over-consume the service beyond what is efficient.

There are other reasons why merchants might balk at being forced to offer cash discounts rather than surcharges. Laws permitting only cash discounts put merchants at a competitive disadvantage, because the only way for merchants to charge for the cost of credit is to raise what they advertise as their base price, and then offer the discount off that increased price. Edmund W. 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, 225 (1990). This puts merchants who offer a cash discount at a perceived disadvantage when compared with merchants who spread their credit costs uniformly among all customers, because the latter can thereby advertise their goods at a lower base price.

Merchants may also wish to avoid incentivizing cash purchases for fear of being stigmatized. This is because in some quarters, cash transactions are used to evade taxes or hide money earned illegally from authorities. Merchants may thus fear that by openly encouraging cash payments, they might be seen by customers as unsavory or generally unscrupulous. *E.g.*, JA 107.

For these reasons, a "discount" is much less effective than a "surcharge" in explaining costs to customers and persuading them to use cheaper payment mechanisms. Indeed, if surcharges and discounts were behaviorally equivalent—and truly synonyms in the real world—then state no-surcharge laws would not exist. The entire *raison d'être* for no-surcharge laws stems from the fact that a surcharge has a *different* communicative effect than a discount.

II. No-surcharge laws serve no legitimate state interest.

No-surcharge laws exist to protect credit-card companies' profits by disguising the costs of credit and depriving merchants of the ability to explain those costs to consumers. Respondents do not seriously dispute these motivations, but contend that that no-surcharge laws are nevertheless needed to protect consumers in spite of the speech toll they exact from merchants. Yet such laws offer consumers no protection that other, better-targeted laws could not provide without inhibiting merchants' right to communicate accurate price information to consumers. Indeed, no-surcharge laws are often harmful to poorer consumers, frequently imposing regressive cross-subsidies whereby poorer consumers are made to pay for their wealthier friends' credit-card rewards.

A. State no-surcharge laws are motivated by credit-card-industry protectionism.

The legislative origins of state no-surcharge laws reveal them for what they really are: industry-lobbied lawmaking efforts aimed at ensuring a bounty of inflated profits for credit-card companies.

Although there had once been federal legislation banning surcharges, state no-surcharge laws did not begin to appear until 1981, when the federal surcharge ban temporarily lapsed, *Economic Costs,* note 2, *supra*, at 1381 & n.216, and even more appeared after the federal ban's permanent lapse in 1984, *ibid.*

The credit card industry was undeniably the driving force behind these legislative efforts. But the industry went to great—and greatly deceptive—lengths to make it *appear* as though the laws had consumer support. Credit-card companies financed the creation of a faux consumer group called "Consumers Against Penalty Surcharges," which was later revealed to be nothing more than a marketing ploy lacking any true backing from consumers. *See* Memo from Kate Krell 3, July 24, 1987, <bit.ly/2fLyUNB> (emphasizing the work of public-relations firm Hill & Knowlton in "put[ting] together 'Consumers Against Penalty Surcharges' for a coalition of credit card companies"). American Express, the purveyor of the most expensive payment instruments in the economy, which thus stood the most to lose from surcharging, even bragged that it had "established" Consumers Against Penalty Surcharges, and that the group was "instrumental in helping achieve state bans on surcharges in New York, California, Texas, Connecticut, Colorado, and Kansas." Meredith M. Fernstrom, Senior Vice-President—Public Responsibility, American Express Company, *The Corporation and the Consumer: Obligation or Opportunity?* Consumer Interests Ann. 353, 355 (1988), <bit.ly/2goqvQi>. *See also* Maxwell Glen & Cody Shearer, *Credit card companies discrepancies found between television ads, letters mailed,* Univ. Press (Beaumont Texas), Apr. 12, 1984, at 3, <bit.ly/2g6rKky> (noting that American Express had hired a Carter administration official to organize Consumers Against Penalty Surcharges); AP, *House for Credit Card Fee Ban*, N.Y. Times, Apr. 4, 1984 (noting that "Besides American Express, credit surcharges are being opposed by the other major card companies, the American Bankers Association and Consumers Against Penalty Surcharges, a coalition that receives funds from American Express and Visa").

True consumer groups strongly opposed the adoption of this collection of no-surcharge laws, claiming that they "give[] consumers incorrect signals about credit—making it appear to be free when it in fact has substantial costs." 127 Cong. Rec. 4228 (Mar. 12, 1981)*; see also, e.g.*, JA 65-66 (noting that "the credit card companies are trying to pass a similar prohibition [to the expired federal no-surcharge law] in the California legislature"); JA 63-64 (in opposition to California's no-surcharge law). The fact that these laws were enacted at the behest of the credit-card lobby, under a shroud of deception, and over the strong objection of actual consumers, provides reason to be skeptical about whether they were motivated out of any true desire to protect consumers.

B. These laws do not protect consumers.

When the supposedly consumer-protective motivations behind no-surcharge laws are closely examined, any actual benefit to consumers is hard to find. Respondents claim that these laws generally advance the sorts of consumer-focused goals that states faced with First Amendment challenges usually unearth. But none of these justifications stands up under scrutiny, because narrower, more targeted laws would do a better job at addressing many of the concerns Respondents claim to care about, and in many instances, no-surcharge laws actually prove counterproductive to Respondents' asserted goals.

1. Credit card surcharges are not inherently deceptive.

Recognizing that there is nothing *necessarily* deceptive about telling customers that they must pay more for the convenience and increased cost of paying by credit card, Respondents insist that surcharges are nonetheless inherently deceptive—so as to justify a complete ban—on the theory that surcharges would inevitably lead to deceptive "bait-and-switch" tactics that might occur if merchants posted a cash price for a good or service, and then asked customers to pay a surcharge when they wished to by credit card. Respondents invoke examples culled from congressional testimony from the 1970s, when credit cards were a new invention, regarding "gas stations that lure[d] drivers from the road with one posted price only to charge more per gallon at the pump for credit-card users." Schneiderman C.A. Br. 10.

This justification for a no-surcharge law lapses into tautology, because to suggest that credit-card surcharging practices *inevitably* foster merchant deception assumes that a reasonable consumer would be justified in thinking that no merchant *would ever* impose a separate surcharge for credit, such that when the consumer saw the advertised price, she would reasonably assume she would *never* pay more than that price for the convenience of paying by credit. If any consumer currently labors under that assumption, it is entirely because no-surcharge statutes exist, and merchants therefore do not surcharge. That says nothing about whether such assumptions can reasonably persist after those bans are lifted.

The view that credit-card surcharging practices are inherently deceptive also overlooks the nature of payment systems and the comfort that customers have now achieved with them. When customers purchase goods or services on credit, they are not understood to be engaging in a single transaction. Rather, they are engaging in two transactions: one for the sale of the underlying good or service, and another for the service of arranging payment. It is not deceptive for the merchant to ask that the consumer pay for those things separately. Nor is it necessarily deceptive if that cost is not advertised alongside the price of the good itself. After all, there are many charges, such as sales taxes (which themselves vary considerably across jurisdictions) that are routinely tacked onto the advertised price, and no one suggests that advertising prices without including the associated sales taxes is deceptive.

Nor, for that matter, must a merchant bake all of its costs or services into a single advertised price to avoid deceiving consumers. Merchants might wish to provide a number of services alongside the sale of the underlying good or service, and charge separately for these services through surcharges. For example, if a merchant agreed to accept foreign currency, she might wish to impose a surcharge to cover the risk that the exchange rate might change before the foreign currency could be converted to dollars. It would be uncontroversial to suggest that a separate surcharge would be appropriate and not deceptive in such instances, and if so, it is hard to understand why it is not appropriate in the credit-card context.

That is not to say that surcharges are inherently *immune* from abuse by unscrupulous merchants; indeed, such abuse may have occurred in the gas station examples relied upon by Respondents. But if states were truly concerned about protecting consumers from hidden surcharges, it would be better to prescribe by law that surcharges be prominently disclosed rather than prohibit them outright. This is what some states have done, *see* Minn. Stat. § 325G.051(1)(a), and what federal law requires for ATM surcharges. 12 C.F.R. § 1005.16. Indeed, misleading behavior in commerce is already generally prohibited under New York law, *see* N.Y. Gen. Bus. Law § 349; *id.* §§ 350 & 350-a, and authorities in New York have used these false-advertising laws to police bait-and-switch tactics in the context of credit cards without any need to resort to the no-surcharge law. *See* JA 144-45. In short, laws on the books already prevent the deceptive behavior Respondents are worried about, making a complete ban both unwarranted and unnecessary.

2. Surcharges are not especially likely to engender consumer confusion.

Respondents also argue that surcharges can result in consumer confusion, on the theory that even if notice is given of the surcharge, consumers might have difficulty engaging in the "multiple math problems" required to compare a discount offered by one merchant with the surcharge offered by another. Schneiderman C.A. Br. 9. But pure apples-to-apples comparisons are hard to come by in the modern shopping world. Consumers must frequently engage in imperfect comparisons, forced to evaluate distinctions not only in the quality and features of the products themselves, but also in the warranties, privacy policies, shipping costs, handling charges, processing fees, and applicable taxes that come with them. Among these myriad complexities in comparison shopping, there is no reason to single out credit-card surcharges, especially when a customer can make meaningful comparisons between discounts and surcharges by rough approximation without engaging in any difficult or complex math.

3. Permitting surcharges will not facilitate price-gouging.

Respondents suggest a third reason to bar surcharging is to prevent price gouging and profiteering. Schneiderman C.A. Br. 10, 43. Here Respondents misattribute problems actually caused by generally uncompetitive industries and local monopolies to be caused instead by credit-card surcharges. When these anti-competitive conditions exist, businesses will exercise outsized market power, which they will no doubt tend to abuse, in surcharging or anywhere else. In such circumstances, the problem is not surcharging, or any other particular mechanism of exercising market power, but the general lack of competition that fosters concentration of undue market power in the first place.

Indeed, surcharges can be the *solution* to anti-competitiveness among merchants and credit-card companies alike. Allowing merchants to label their credit-card fees as surcharges will allow customers to compare surcharges, and to determine whose are lowest. That will force merchants to keep their surcharges low—*and* force credit-card companies to keep *their* fees low—which will in turn ensure that price-gouging is unlikely to occur.

Moreover, no-surcharge laws hardly prevent price-gouging, because under those laws as written, merchants are already free to charge whatever unjust sums they want: they need only inflate the base price rather than the surcharge. Indeed, states truly concerned about the potential for price-gouging are free to impose limits on the surcharges that merchants may charge. Once again, such narrow laws targeting specific abuses would be preferable to a complete ban on use of the label.

It is not necessary to speculate, however, about concerns of price gouging and profiteering, because Australia's recent experience with credit-card surcharges shows such fears to be unfounded. In 2003, the Reserve Bank of Australia enacted a set of reforms of the country's credit card industry, which included allowing merchants to surcharge for credit-card swipe fees. Following the reforms, some merchants began to surcharge, and concerns arose that some merchants were abusing that freedom to profiteering ends. But after an exhaustive investigation, the New South Wales government's Office of Fair Trading and CHOICE, the leading Australian consumer advocacy group, found no actual concrete evidence that profiteering was occurring. CHOICE, *Choice Report, Credit Card Surcharging in Australia* 12 (2010), <bit.ly/1ACjSYt>.

Although some Australian merchants were found to surcharge substantially more than the *national average* swipe fees, there is no evidence that even these merchants were charging more than *their own average* swipe fee, which could vary from the national average as the result of either the types of cards the merchants accepted or the merchants' particular risk profiles. *Ibid; see also* Reserve Bank of Australia, *Review of Payment Card Regulation, Conclusions Paper* 33 (May 2016) (*Conclusions Paper*), <bit.ly/2g4Icnz>. Thus, the Reserve Bank of Australia's own study determined that excessive surcharging might have been occurring in "a small number of cases," *see* Reserve Bank of Australia, *Review of Payment Card Regulation, Consultation Paper* 8 (Dec. 2015), <bit.ly/2g3y8Yr>, but even in these isolated instances, none was deemed to be true profiteering.

Perhaps more importantly, the study found that these isolated instances of excessive surcharging were confined to only a "few industries," *ibid.*, particularly the airline and taxi industries, perhaps as the result of anti-competitive forces particular to these areas of the economy, and Australian governmental authorities responded appropriately by attacking the perceived problem narrowly. The Australian federal government passed legislation this year permitting the Reserve Bank of Australia to issue regulations to limit excessive surcharging.[7] *See* Competition and Consumer Amendment (Payment Surcharges) Act 2016 (Feb. 25, 2016). Rather than impose a complete surcharge ban, the Reserve Bank of Australia has instead implemented regulations restricting surcharges to the average cost of cards of a particular brand. Reserve Bank of Australia, Payment Systems (Regulation) Act 1998, Standard No. 3 of 2016: *Scheme Rules Relating to Merchant Pricing for Credit, Debit, and Prepaid Card Transactions* (2016), <bit.ly/2aBkBJM>; *Conclusions Paper* 66.

The Australian experience reveals not only the absence of widespread merchant profiteering through surcharging (or indeed, conclusive evidence of *any* merchant profiteering), but also that such concerns can be addressed through narrowly tailored laws limiting surcharging to actual costs imposed by particular payment methods. A general ban on surcharging thus limits speech far

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[7] Five Australian states have separately capped surcharging by taxis. *Conclusions Paper* 37.

more than is necessary to advance New York's interest in protecting consumers from unfair profiteering.

4. The potential that surcharges will provoke consumer responses is a virtue, not a vice.

By far the worst of Respondents' justifications for no-surcharging laws is their concern that consumers might become upset when they learn how much merchants charge for credit-card processing services, or when they learn how much credit-card companies are charging for *their* services. Schneiderman C.A. Br. 43. Consumers may well find this price information upsetting. But that is hardly a vice—on the contrary, it is precisely the point.

If consumers feel that a merchant is penalizing their use of a credit card, they may be more likely to find a different, cheaper card, use another, cheaper, payment method, or even take their business to a merchant that does not surcharge. Indeed, the potential that surcharges might shape customer behavior towards merchants is a powerful and important check on merchants' ability to surcharge that will prevent abuse. Merchants that impose surcharges risk alienating their own clientele, which means that they will only surcharge when the surcharge is worthwhile, which only occurs when swipe fees are excessively high. U.S. swipe fees are the highest in the developed world. *Reforming Card Swipe Fees* 1. The ability to surcharge would bring market pressure to bear on these excessive swipe fees, and would result in their decline until an equilibrium point is reached at which merchants find it no longer worthwhile to surcharge. *See Economic Costs,* note 2, *supra*, at 1355. In this way, the invisible forces of the market would foster price-reducing competition among merchants and credit-card companies alike.

This is not speculative economic theory—it is precisely what occurred in Australia following its reforms in 2003. The Reserve Bank of Australia now permits merchants to surcharge. Some do, but far from all, because the incentive to do so has been reduced by the fact that swipe fees in Australia fell dramatically following the reforms. Fees for MasterCard and Visa credit cards fell by 46%—and those for American Express fell by 33%. *See* Reserve Bank of Australia, *Average Merchant Fees for Debit, Credit and Charge Cards, Statistical Table C3, Series CMFCBMVT and CMFCAET* (Nov. 2016), <bit.ly/2f8RpXt> (percentages calculated as 1 minus the quotient of September 2016 fees over March 2003 fees). Accordingly, surcharges could prove a boon, rather than a burden, for consumers, because lower costs for merchants could translate into lower prices or better services for consumers.

C. No-surcharge laws impose regressive cross-subsidies benefitting wealthier consumers and credit card companies.

Not only do no-surcharge laws hinder the efficiency-producing potential for the market to hold merchants and credit-card companies in check, they frequently cause actual *harm* to consumers. This is because such laws incentivize a regressive cross-subsidy of money and purchasing power from the users of low-cost payment instruments (cash, check, and PIN-debit) to the users of high-cost payment instruments (credit and signature-debit). In this way, laws ostensibly written to protect consumers are actually made to benefit the affluent at the expense of the poorest in society.

Because no-surcharge laws prevent merchants from charging extra for the most expensive payment instruments, and because discounting is a poor substitute "synonym," no-surcharge laws incentivize merchants to provide only unitary or "homogenized" pricing, whereby all consumers pay the same price for goods and services irrespective of their payment method. Virtually all merchants have responded to this incentive and adopted homogenized pricing: multi-tiered pricing is very much a rarity. *See Economic Costs,* note 2, *supra*, at 1350. Indeed, the FTC has observed that when certain merchants were informed that they were charging illegal surcharges, they uniformly stopped surcharging, but none instituted cash discounts. *Cash Discount Act, 1981: Hearings Before the Subcommittee on Consumer Affairs of the S. Banking, Housing, and Urban Affairs Comm. on S. 414*, 97th Cong. 9, 126 (Feb. 18, 1981). Accordingly, even those merchants who expressed a clear preference for surcharging found that discounts were not worth pursuing as an alternative.

Homogenized pricing forces merchants to distribute the increased marginal costs that *some* customers impose through their use of credit onto *all* of the merchant's customers. This forces some customers to pay the costs of credit without actually receiving the benefits associated with using credit. *Social Costs*, note 2, *supra*, at 32-35. Consumers using cheaper payment methods are therefore subsidizing those using more expensive payment methods. The particular dynamics of this cross-subsidy will vary among merchants, as the result of differences in each merchant's pricing and payment mix, but those cross-subsidies always exist.

The amount of this subsidy is substantial, and varies greatly with the kind of card used. For example, Visa's interchange fee schedule (dated April 16, 2015) has up to four tiers of pricing for certain merchant categories, based on the rewards program of the customer's card. Thus, if a consumer were to use a Visa Signature Preferred card at a restaurant, the interchange fee would be 2.4% of the transaction amount plus $0.10. If the consumer used a Visa Signature card, the fee would be 2.3% of the transaction amount plus $0.10. For the Visa Traditional Rewards card, the fee would be 1.95% of the transaction amount plus $0.10. And if the consumer used a non-rewards card, the fee would be 1.54% of the transaction amount plus $0.10. *See VISA USA Interchange Reimbursement Fees* 8 (Apr. 18, 2015), <vi.sa/2fpv1Km>. With a Visa business card, the fee could be as high as 2.95% of the transaction amount plus $0.20. *Id.* at 15. Accordingly, the fees on a $30 restaurant meal could vary between $0.562 to $1.085, depending on the type of Visa credit card used. And if the same meal were purchased with a Visa debit card, the fee could be as little as 0.05% of the transaction amount plus $0.21, or $0.225. Accordingly, the costs among Visa's own cards might vary by 389 percent, illustrating how great the subsidy can be, and how much it can vary with the lavishness of the perks associated with particular cards.

This cross-subsidy is also inherently regressive, because the most expensive payment methods are used primarily by very affluent individuals. *Social Costs*, note 2, *supra*, at 35-36. In contrast, the cheaper payment methods—debit card and cash—tend to be used by less affluent individuals. *Ibid.*

In its most dramatic form, this cross-subsidy means that consumers using food stamps or receiving welfare payments may find themselves subsidizing first-class upgrades and spa vacations for affluent rewards card users. States administer three key federal welfare programs: the

Supplemental Nutrition Assistance Program ("SNAP" or "food stamps"), Temporary Assistance for Needy Families ("TANF") and the Special Supplemental Nutrition Program for Women, Infants, and Children ("WIC"). All states are required to disburse SNAP benefits to consumers only through special debit cards known as electronic benefit transfer cards ("EBT cards"). *See* 7 U.S.C. § 2016. Additionally, many states also issue TANF and WIC benefits for through EBT cards. *See Nat'l Conf. of State Legis., Restrictions on Use of Public Assistance Electronic Benefit Transfer (EBT) Cards* (2015), <bit.ly/2goEFRI>.

State EBT card programs are administered by private banks. These banks are prohibited by federal law from charging per-transaction fees to merchants for EBT card payments. 7 U.S.C. § 2016(h)(13). Although merchants have fixed costs for accepting EBT transactions in general, there is no per-transaction cost. Thus, one of the largest payment cost differentials is between EBT payments and credit payments. As many stores, particularly grocery stores, are frequented by both EBT consumers and rewards-card users, there is a high likelihood that such a regressive cross-subsidy regularly occurs in these stores. This is not only inherently unfair to poorer individuals, who must be forced to subsidize their neighbors' lavish vacations, but it also undermines the food-stamp program and other federal welfare programs by diminishing the purchasing power of food stamps and welfare through price inflation.

The regressive cross-subsidy also creates problems for a subset of the *subsidized* credit card users. The cross-subsidy encourages inefficient usage of credit cards. Unconstrained by price signals at the till, consumers tend to overuse credit as a payment method. *See* Oren Bar-Gill, *Seduction by Plastic*, 98 Nw. U. L. Rev. 1373, 1396-402 (2004); Paul Heidhues & Botond Köszegi, *Exploiting Naivete about Self-Control in the Credit Market*, 100 Am. Econ. Rev. 2279, 2303 (2010). In addition, consumers tend to spend more when shopping on credit. *See* Drazen Prelec & Duncan Simester, *Always Leave Home Without It: A Further Investigation of the Credit-Card Effect on Willingness to Pay*, 12 Marketing Letters 5, 11 (2001). Many consumers, however, systematically underestimate their ability to repay their credit-card debt. Bar-Gil 1400-01. As consumers use credit cards for more (and larger) transactions, there is a higher likelihood that some will end up paying unanticipated credit card fees and interest, such as for accidental late payments or because unexpected life events (death, disability, divorce, or dismissal) interfere with their ability to repay card balances in full and on time. *See Social Costs*, note 2, *supra*, at 43-51. Fees and interest might offset the entire cross-subsidy benefit for some card users, and some card users are also likely to find themselves with unmanageable debt loads. Increased credit usage also appears to contribute to consumer bankruptcy filings, low savings rates, decreased purchasing power, and inflation. *Ibid.;* Teresa A. Sullivan et al., *the Fragile Middle Class: Americans In Debt* 108-40 (2000); Robert D. Manning, *Credit Card Nation: the Consequences of America's Addiction to Credit* 127, 127-32, 291-99 (2000).

Finally, it is important to note that while there is a regressive cross-subsidy created by the homogenized pricing that state no-surcharge laws encourage, the subsidy does not go solely, or even predominantly, to rewards card users. Instead, it goes to credit-card companies. Rewards cards have higher costs than non-rewards cards, but only a fraction of that increased cost is rebated to the cardholders in the form of rewards. According to one study, rewards program benefits and administration combine to only 45% of interchange fees. Amy Dawson & Carl Hugener, Diamond Mgmt. & Tech, Consultants, *A New Business Model for Card Payments* 9 (2006) <bit.ly/2fE8jRq>. Accordingly, this it is not simply a matter of food stamp users subsidizing rewards card users, but of food stamp users subsidizing credit-card-issuing banks.

In sum, the limits no-surcharge laws place on merchants' ability to communicate with their customers are not merely hypothetical or hyper-technical. No-surcharge laws meaningfully restrict the sharing of information that could otherwise benefit both merchants and consumers. That results in real harms to real people, which cannot outweigh any marginal benefits that might be obtained from them, especially when those benefits flow largely to credit-card companies.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted,

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