No. 15-50168

In the United States Court of Appeals for the Fifth Circuit

LYNN ROWELL, doing business as Beaumont Greenery; MICAH P. COOKSEY; MPC DATA AND COMMUNICATIONS, INCORPORATED; MARK HARKEN; NXT PROPERTIES, INCORPORATED; PAULA COOK; MONTGOMERY CHANDLER, INCORPORATED; SHONDA TOWNSLEY; TOWNSLEY DESIGNS, L.L.C.,

Plaintiffs-Appellants,

v.

LESLIE L. PETTIJOHN, in her official capacity as Commissioner of the Office of Consumer Credit Commissioner of the State of Texas,

Defendant-Appellee.

On Appeal from the United States District Court for the Western District of Texas
No. 1:14-cv-00190-LY (Hon. Lee Yeakel)

AMICI CURIAE BRIEF FOR CONSUMER ACTION, NATIONAL ASSOCIATION OF CONSUMER ADVOCATES, NATIONAL CONSUMERS LEAGUE, U.S. PUBLIC INTEREST RESEARCH GROUP AND TexPIRG SUPPORTING PLAINTIFFS-APPELLANTS

Daniel A. Small
Benjamin D. Brown
COHEN MILSTEIN SELLERS & TOLL, PLLC
1100 New York Avenue, N.W.
Washington, D.C. 20005

Counsel for Amici Curiae

Dated: June 16, 2015

CERTIFICATE OF INTERESTED PERSONS

The plaintiffs-appellants have set forth the interested parties in this case at pages i–ii of their opening brief. In accordance with Fifth Circuit Rule 29.2—which requires "a supplemental statement of interested parties, if necessary to fully disclose all those with an interest in the amicus brief"—undersigned counsel of record certifies that, in addition to those persons listed in the plaintiffs-appellants' statement, the following persons have an interest in this *amici curiae* brief. These representations are made in order that the judges of this Court may evaluate possible disqualification or recusal.

1) Consumer Action, *amicus curiae* in this case;
2) National Association of Consumer Advocates, *amicus curiae* in this case;
3) National Consumers League, *amicus curiae* in this case;
4) U.S. Public Interest Research Group, *amicus curiae* in this case;
5) TexPIRG, *amicus curiae* in this case; and
6) Attorneys for *amici*: Daniel A. Small and Benjamin D. Brown (Cohen Milstein Sellers & Toll, PLLC)

Dated: June 16, 2015

/s/ Daniel A. Small
Daniel A. Small
Counsel for *Amici*

CORPORATE DISCLOSURE STATEMENT

Undersigned counsel hereby certifies, pursuant to Federal Rule of Appellate Procedure 26.1(a), that Consumer Action, National Association of Consumer Advocates, National Consumers League, U.S. Public Interest Research Group and TexPIRG have no parent corporation and that no publicly held corporation owns 10% or more of their stock.

Dated: June 16, 2015

/s/ Daniel A. Small
Daniel A. Small
Counsel for *Amici*

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

OTHER AUTHORITIES

PRELIMINARY STATEMENT[1]

The plaintiff-appellant merchants in this case seek reversal of the district court's decision, which permits the enforcement of Texas's unconstitutional no-surcharge law, Tex. Fin. Code § 339.001 (2014). This law allows merchants to directly pass on the cost of credit card swipe fees to consumers by charging different prices depending on whether a consumer pays with cash or credit—but only if the merchants frame the price difference as the credit card industry wants them to: "discounts" for cash are allowed, equivalent "surcharges" for credit are not.

The way this price difference is framed matters, however, because "[b]ehavioral economics explains that consumers are more sensitive to a loss than to a gain." Fumiko Hayashi, FEDERAL RESERVE BANK OF KANSAS CITY, *Discounts and Surcharges: Implications for Consumer Payment Choice*, 2 (June 2012). "In the context of consumer payment choice," consumers "react more strongly to surcharges than to discounts," meaning that discounts "have a smaller impact on payment behavior than surcharges of the same value." *Id.* By requiring merchants

[1] Pursuant to Federal Rule of Appellate Procedure 29(a), all parties have consented to the filing of this brief. Moreover, pursuant to Fed. R. App. P. 29(c)(5), counsel for *amici* state that no party or party's counsel authored this brief in whole or in part, and no party or party's counsel contributed money that was intended to fund preparing or submitting this brief. No person—other than the amicus curiae—contributed money that was intended to fund preparing or submitting this brief.

to label any price difference as a cash "discount" rather than a credit "surcharge," Texas's no-surcharge law prohibits them from effectively communicating the cost of credit to their customers—and thus furthers the credit card industry's goal of keeping consumers in the dark about how much they pay for credit. Moreover, because merchants are afraid of crossing the line between discounts and surcharges, the law in practice deters most merchants from engaging in differential pricing altogether. For reasons discussed more fully below, that is an especially bad outcome for consumers.

Amici curiae are national consumer advocacy organizations that support reversal of the lower court's decision and file this brief to make four primary points. *First*, the Texas no-surcharge law results in supra-competitive interchange fees that, as a practical matter, merchants are forced to recoup by raising prices for all consumers. *Second*, the no-surcharge law results in highly regressive cross subsidies of high cost credit cards and rewards programs by other consumers—which, "[i]n the most extreme terms, . . . mean that first-class upgrades from frequent flier miles are subsidized by food stamp recipients." Elizabeth Warren, *Antitrust Issues in Credit Card Merchant Restraint Rules*, Tobin Project Risk Policy Working Group, 1 (May 6, 2007), *available at* http://www.docstoc.com/docs/26252409/Antitrust-Issues-in-Credit-Card-Merchant-Restraint-Rules. *Third*, less restrictive means—in the form of disclosure

requirements rather than speech codes—are available to protect consumers from potential merchant abuses.

INTERESTS OF AMICI

Amici curiae are five leading consumer advocacy groups whose decades of collective experience advocating for consumers make them qualified to assist the Court in understanding the substantial public interest advanced by the challenge to the no-surcharge law. Amici have broad knowledge about the history of credit cards and are particularly well qualified to assist the Court in understanding how the public interest, and consumer interests in particular, are undermined by the challenged statute, which was originally advanced by the credit card industry, and by similar statutes that are being introduced by and lobbied for by the industry in various other states on an ongoing basis.

Consumer Action has been educating consumers on credit card related matters, including credit card surcharges, for more than four decades. Consumer Action has been a champion of underrepresented consumers since 1971. A national, nonprofit 501(c)3 organization, Consumer Action focuses on financial education that empowers low to moderate income and limited-English-speaking consumers to financially prosper. It also advocates for consumers in the media and before lawmakers to advance consumer rights and promote industry-wide change particularly in the fields of credit, banking, housing, privacy, insurance and utilities.

National Association of Consumer Advocates (NACA) is a non-profit corporation whose members are private and public sector attorneys, legal services attorneys, law professors, and law students whose primary focus involves the protection and representation of consumers. NACA's mission is to promote justice for all consumers by maintaining a forum for information sharing among consumer advocates across the country and serving as a voice for its members as well as consumers in the ongoing effort to curb unfair and abusive business practices.

National Consumers League is America's oldest consumer organization, representing consumers and workers on marketplace and workplace issues since its founding in 1899. NCL provides government, businesses, and other organizations with the consumer's perspective on a wide range of concerns, including the cost of payment systems.

U.S. Public Interest Research Group (U.S. PIRG), the federation of state Public Interest Research Groups, is a national, nonprofit, non- partisan consumer advocacy organization that stands up to powerful special interests on behalf of the American public. **TexPIRG** is the statewide affiliate of the federation. Both U.S. PIRG and TexPIRG have long advocated on the issue of swipe-fee reform. They believe that cash customers should not pay more to subsidize credit card reward programs and supports efforts to make the costs of credit transparent to consumers.

BACKGROUND

Texas's no-surcharge law makes it a crime to "impose a surcharge on a buyer who uses a credit card for an extension of credit instead of cash, check, or a similar means of payment." Tex. Fin. Code § 339.001 (2014). This law, and others like it, effectively deprives merchants of a valuable tool that could otherwise be utilized to help remedy the grossly inefficient and anticompetitive system of payment that now drastically and detrimentally affects American consumers.

American consumers pay the highest interchange fees in the world, fees that are many times higher than the fees paid by consumers in most other developed countries. These excessive fees are passed on to consumers in the form of higher retail prices on the goods and services they purchase every day. The main reason that there is not more awareness and outcry about this issue is that those fees are hidden from consumers because merchants are effectively prevented from instituting pricing structures that reflect those fees in the form of discounts or surcharges. Importantly, "no surcharge" rules do not prevent merchants from passing on the costs of these supra-competitive fees. They only prevent merchants from passing on those costs in a sensible manner more closely tied to the actual use of credit cards and in a manner that could introduce price competition among payment systems. The results are higher general retail prices and higher interchange fees. This also eliminates an important mechanism that would

otherwise be used to inform consumers about the issue of discount rates and the costs of credit card use, preventing meaningful and cost conscious decisions about payment systems. For these reasons, prohibitions on surcharging are extremely detrimental to American consumers.

ARGUMENT

I. THE NO-SURCHARGE LAW FORCES MERCHANTS TO RECOUP SUPRA-COMPETITIVE INTERCHANGE FEES BY RAISING STICKER PRICES FOR ALL CONSUMERS.

The purpose and practical effect of the no-surcharge rule is to conceal the underlying true costs of credit by spreading those costs among all consumers. To adequately understand the policy considerations relating to the no-surcharge law, one must first understand the merchant credit card fees that comprise the underlying problem. Every time a consumer uses a credit card, the merchant generally pays 1–4%[2] of the transaction value in "merchant fees," most of which go to the issuing bank as "interchange fees."[3] Interchange fees in America are the

[2] These fees are usually a hybrid of a per-transaction price and a percent of transaction cost, and sometimes can reach 15%, depending on the risk factor of the merchant. *See* Elizabeth Warren, *Antitrust Issues in Credit Card Merchant Restraint Rules*, Tobin Project Risk Policy Working Group, 1 (May 6, 2007) *available at* http://www.docstoc.com/docs/26252409/Antitrust-Issues-in-Credit-Card-Merchant-Restraint-Rules.

[3] These fees are technically divided between three banking entities, but for the purposes of this brief, the technical structure of credit card payment systems is irrelevant. *See* Adam J. Levitin, *Priceless? The Social Costs of No-Surcharge Rules*, Business, Economics and Regulatory Policy Working Paper Series No. (continued…)

highest in the world, generating approximately 50 billion dollars per year for credit card issuers, with more than 200 million dollars of it from federal agencies alone.[4] The interchange fee rates jumped 23% between 2000 and 2006, but because the volume of credit card transactions also increased dramatically, the absolute cost of interchange fees for merchants increased 139% during the same period.[5] "For many merchants, credit card acceptance has become the fastest growing cost of doing business,"[6] while MasterCard and Visa have seen a 74% increase in interchange revenues, now accounting for 20% of their overall revenue.[7]

No-surcharge rules are the reason that credit cards are increasing in use despite being "more expensive on average for merchants than cash and checks,"[8]

973974, 7 (Jan. 2008 Revision) *available at* http://papers.ssrn.com/sol3/papers.cfm? abstract_id=1011106.

[4] *See, e.g.*, Keith Bradsher, *U.S. Looks to Australia on Credit Card Fees*, N.Y. TIMES, (Nov. 24, 2009), http://www.nytimes.com/2009/11/25/your-money/credit-and-debit-cards/25card.html?pagewanted=all; Andrew Martin, *Card Fees Pit Retailers Against Banks,* N.Y. TIMES (Jul. 15, 2009) http://www.nytimes.com/2009/07/16/ business/16fees.html.

[5] Levitin, *supra* note 2, at 49.

[6] Adam J. Levitin, *Priceless? The Economic Costs of Credit Card Merchant Restraints*, 55 UCLA L. REV. 1321, 1345 (2008) (citing *Financial Services Issues: A Consumer's Perspective, Hearing Before the Subcomm. on Financial Institutions and Consumer Credit of the H. Comm. on Financial institutions,* 108th Cong. 115 (2004) (statement of John J. Motley III, Sr. Vice President, Food Marketing Institute)).

[7] *See* James J. Daly*, Tenuous Gains in Card Profitability*, CREDIT CARD MGMT., May 2001, at 32, 33; Jeffrey Green, *Exclusive Bankcard Profitability 2007 Study & Annual Report*, CARDS & PAYMENT 27 (May 2007).

by preventing most merchants from passing these fees to the consumers who choose to use credit cards. By returning a small portion of these revenues in the form of rewards to a fraction of consumers, credit card companies have constructed a system whereby consumers actively, and unknowingly, choose the most costly payment system. Increased fees to merchants fuel greater rewards, which fuel greater use, in a race to the top—precisely the opposite of competitive pricing.

The potent combination of market power and restraints on merchant speech have led to increased retail sticker prices and a massive cross-subsidy among consumers. "[H]undreds of thousands of merchants . . . must take credit cards at any price because their customers insist on using those cards." *United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 341 (S.D.N.Y. 2001) *aff'd*, 344 F.3d 229 (2d Cir. 2003).[9] Simultaneously, the no-surcharge law prevents merchants from communicating or allocating the cost of credit card usage to the consumers who

---

[8] David S. Evans & Richard Schmalensee, INTERCHANGE FEES IN CREDIT AND DEBIT CARD INDUSTRIES, PROCEEDINGS OF THE 2005 FEDERAL RESERVE BANK OF KANSAS CITY CONFERENCE, *The Economics of Interchange Fees and Their Regulation: An Overview,* 31 (2005), *available at* http://ssrn.com/abstract=744705.

[9] *See also United States v. Visa U.S.A., Inc.*, 163 F. Supp. 2d 322, 340-41 (S.D.N.Y. 2001) *aff'd*, 344 F.3d 229 (2d Cir. 2003)); General Court of the European Union, T-111/08, *MasterCard Inc. et al., v. Commission* (2012) 28 ("[T]he MasterCard payment organisation [sic] collectively exert market power vis-à-vis merchants and their customers.") *available at* https://www.competitionpolicyinternational.com/the-opinion-of-the-european-general-court-2/.

impose them by choosing to pay with credit cards.[10] In practice, merchants must raise the unified sticker prices for all their goods to cover the costs of credit card merchant fees. Cash buyers pay higher retail prices than they otherwise should, while credit card customers are discounted from the true cost of their transaction.[11] Credit card consumers receive all the benefits of credit card use, while cash customers receive no benefit and pay a premium to cover the difference—a pervasive cross-subsidy operating on all transactions. As Elizabeth Warren has put it: No-surcharge rules operate to force most merchants "to charge *all* consumers higher prices in order to cover the costs of accepting credit card transactions. As a result, non-credit consumers (food stamps, cash, checks, debit) end up subsidizing credit card consumers and, indirectly, subsidizing the entire credit card industry."[12]

The available empirical studies suggest these effects are not negligible. A study of gas station pricing in 1989—when fees were far lower—showed that at stations which maintained unified pricing, cash consumers paid a 1.5% premium over the national averages to subsidize a discount from cost to credit card users of

[10] Though technically allowed, discounts are also chilled by the no-surcharge law as merchants are justifiably concerned that they will incur criminal charges for violating the no-surcharge law's "subtle semantic distinction . . . as to what is lawful or unlawful. *People v. Fulvio*, 517 N.Y.S.2d 1008, 1015 (Crim. Ct. N.Y. 1987).

[11] *See* Scott Schuh et al., FEDERAL RESERVE BANK OF BOSTON, *Who Gains and Who Loses from Credit Card Payments?* 21 (2010).

[12] Warren, *supra* note 1, at 1.

2%-3.5%.[13] Today, the estimated overall cross-subsidy between cash and credit users is staggering: "The average cash-paying household transfers $149 . . . annually to card users [each of whom] receive[s] an average of $1333 annually from cash users."[14]

The recent explosion in rewards card programs has exacerbated the problem of hidden cross-subsidies considerably. Because, in addition to the no-surcharge law, network rules forbid merchants from selectively accepting credit cards from within a given network, they must increase prices to recoup the costs of increasingly generous, high-end rewards programs. "Rewards cards have risen from less than 25 percent of new card offers in 2001 to nearly 60 percent in 2005" and now are considered to "drive the growth in . . . all credit card usage."[15] The power of rewards to increase credit card usage—though vitally, not to increase overall consumer spending—is closely tied with increases in interchange revenue. In fact, rewards cards and corporate cards sometime cost merchants twice as much

---

[13] *See* Adam J. Levitin, *The Antitrust Superbowl: America's Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit*, 3 BERK. BUS. L. J. 69, 110 (2006) (citing John M. Barron et al., *Discounts for Cash in Retail Gasoline Marketing*, 10 CONTEMP. ECON. ISSUES 89, 102 (1992)). In Delaware, all customers paid an extra 1.82¢ per gallon so that credit customers could pay 2.37¢ less per gallon than cost. *Id.* at 102. The cash consumer therefore bore between 30%-43% of the marginal cost to the merchant of the costs imposed by credit card transactions. *Id*.

[14] Schuh, *supra* note 10, at 21.

[15] Levitin, *supra* note 5, at 1344–46.

in fees.[16] In 2007, Visa's ultra-premium rewards card's interchange rate at large supermarkets—among the merchants with theoretically the most leverage to negotiate fees—was 2.20% and 10¢ per transaction, roughly double the average fee.[17] For MasterCard, some cards average as much as 3.25% interchange fees.[18]

Far from being a problem for credit card networks, the across-the-board price increases work in their favor: "Card networks have the incentive to charge high interchange fees to inflate retail prices so that they can create more demand for their service . . . . As the card payments become more efficient and convenient than alternatives, the card networks are able to further raise the interchange fees, inflate the value of transactions and hence extract more profits" without lifting consumer surplus and merchant profits.[19] Neither merchants nor non-credit card users gain any marginal benefit from these high-end rewards cards, but they both end up footing the bill for immense credit card company profits, and the generous rewards they provide to a tiny segment of consumers.

No-surcharge laws effectively gag merchants and deny consumers vital information about the relative costs of payment systems, ensuring that cards are

---

[16] Levitin, *supra* note 5, at 1323.
[17] Levitin, *supra* note 5, at 1348.
[18] Levitin, *supra* note 5, at 1333.
[19] Zhu Wang, *Market Structure and Credit Card Pricing: What Drives Interchange?*, 28 INT'L J. OF INDUS. ORG. 86, 93 (2010) *available at* http://www.frbatlanta.org/news/CONFEREN/08payments/08payments_Wang.pdf.

never put into serious price competition with each other or with other payment systems. The largest issuers like Citibank and Chase, representing more than 65% of the market, effectively set their interchange fees collectively, and do not allow merchants to differentiate between card networks from different issuers (*i.e.* Visa vs. Citibank Visa), entirely foreclosing competition.[20] Commercial speech, as this case demonstrates, is essential to a free market economy. *See Bates v. State Bar of Ariz.*, 433 U.S. 350, 364 (1977). In a less competitive environment, companies have less incentive to price competitively and prices therefore increase. *Id.* at 377-78. Commercial speech restraints like the one at issue ensure that issuers will be unconstrained by cost. Thus, issuers will continue to engage in a race to the top of interchange fees, without concern that consumer usage will be impacted.[21] The no-surcharge law effectively maintains unified pricing at the point-of-sale concealing from consumers that credit card users are free riding on cash consumers and simultaneously driving their own prices up. Meanwhile, merchants have no choice but to accept credit card networks' mounting fees increases and expanding market share.

---

[20] *See* Steven Semeraro, *The Antitrust Economics (and Law) of Surcharging Credit Card Transactions*, 14 STAN. J.L. BUS. & FIN. 343, 379–80 (2009); Market Share by Card Issuer, Credithub.com (2010) http://www.cardhub.com/edu/market-share-by-credit-card-issuer/ (last viewed Jul. 1, 2012)

[21] Levitin, *supra* note 5, at 1341 (citing Merchant Discount Fees, NILSON REP., Aug. 2006, at 11; U.S. Interchange Fees, NILSON REP., May 2003, at 10.).

II. THE CROSS SUBSIDIES CREATED BY THE NO-SURCHARGE LAW ARE HIGHLY REGRESSIVE.

Credit card companies direct a small fraction of their supracompetitive profits to their richest customers at the cost of the low-income consumers, effectively implementing a regressive tax on all consumers. Consumers using "cash"—which for purposes of this brief includes checks, debit cards, and food stamps—unknowingly pay a premium that subsidizes the credit card networks and their high income consumers. The distribution of the benefits is no accident: credit card companies almost exclusively target affluent consumers and corporate accounts for the most generous rewards.[22]

On average, cash consumers are far lower income, and embrace a larger proportion of minorities, than the credit card users.[23] Ten percent of adult Americans are completely "unbanked" and therefore ineligible for credit cards.[24] Within the lowest income quintile of Americans, 29% are unbanked.[25] Credit cards are also disproportionately unavailable to minorities: "While less than 5% of the white, non-Hispanic population lacks a bank account, 20% of non-whites and

---

[22] Levitin, *supra* note 5, at 1346 n.76 (citing Burney Simpson, *Merchants Tackle Credit Card Fee Policies,* CARDS & PAYMENTS, 32 Jan. 2006).
[23] *Id.*; *see also* William C. Dunkelberg & Robert H. Smiley, *Subsidies in the Use of Revolving Credit*, 7.4 J. MONEY CREDIT & BANKING 477 (1975).
[24] Warren, *supra* note 1, at 1.
[25] Levitin, *supra* note 2, at 44.

Hispanics are unbanked."[26] Approximately 40% of the lowest income quintile of Americans have a credit card, while 67% households with income of $20-$50 thousand dollar per year, and 97% of households over earning over $120 thousand per year, have at least one credit card.[27] Naturally, the distribution of access to credit cards means that this cross-subsidy overwhelmingly benefits high income consumers: "credit card spending by high-income consumers is nearly five times higher than credit card spending by low-income consumers, and . . . high-income consumers are 20 percentage points more likely to receive credit card rewards."[28] No-surcharge laws facilitate a massive transfer of resources from cash users to credit card users, and even among credit card users, from low-income, low-rewards card users to high-income, high-rewards card users. Never having to bear the costs of their usage, rewards card users use credit cards more often and more exclusively than those without rewards credit cards.[29] "By far, the bulk of the transfer gap is enjoyed by high-income credit card buyers [income $100k+], who receive a $2,188 subsidy every year," as opposed to the low income credit card buyers, who

---

[26] *Id.*
[27] Schuh, *supra* note 10, at 8.
[28] Schuh, *supra* note 10, at 8.
[29] Andrew Ching & Fumiko Hayashi, FEDERAL RESERVE BANK OF KANSAS CITY, *Payment Card Rewards Programs and Consumer Payment Choice,* Working Paper No. 06-02, 4 (2006), *available at* http://www.kansascityfed.org/PUBLICAT/PSR/RWP/ching_hayashi_paper.pdf.)

"receive a subsidy [of] $613."[30] In absolute terms, the estimated transfer is about $1.4 billion to $1.9 billion from rewards on gasoline and grocery purchases alone.[31] Together, the no-surcharge law's effective unified-pricing mandate and the run-away rewards programs (also facilitated by the no-surcharge law) are largely responsible for this enormous regressive and hidden wealth transfer. In effect, this allows credit card companies to tax the poor and give a small share of those proceeds to the rich.

III. THE DISTRICT COURT'S DECISION CANNOT SURVIVE SCRUTINY AND ALTERNATIVE, LESS RESTRICTIVE MEANS ARE READILY AVAILABLE TO PROTECT CONSUMERS FROM POTENTIAL MERCHANT ABUSES WITHOUT HARMING COMMERCE.

The district court erroneously concluded that the Texas statute does not implicate First Amendment concerns. The lower court's decision is wrong on the facts and law. Moreover, the objectives of the statute can be achieved through alternative, less restrictive interventions.[32]

---

[30] Schuh, *supra* note 10, at 21.

[31] *Id.* at 3 (citing Efraim Berkovich, *Card Rewards and Cross-Subsidization in the Gasoline and Grocery Markets*, REV. OF NETWORK ECON. 11.4 (2012)).

[32] Moreover, as plaintiff-appellants correctly point out, the district court employed the wrong standard, rational-basis review, when the statute's content-based speech requirement should have been subject to heightened First Amendment scrutiny. Indeed, each of the potential justifications focuses on the communicative impact of the statute. This only confirms that First Amendment scrutiny is both appropriate and required. *See Bell South v. Farris*, 542 F.3d 499, 510 (6th Cir. 2008) (continued…)

In upholding the constitutionality of the Texas statute, the lower court acknowledged that it "allows a merchant to exact a higher price" (set at whatever amount the merchant wishes) "from a customer who pays with a credit card than from a customer who pays with cash"—but only if the difference is framed as a "discount" rather than a "surcharge." ROA.440. In other words, despite the fact that liability under the statute turns on speech, not conduct, the lower court found that the statute "proscribes a single activity—charging more for a credit-card payment"—and thus "does not implicate First Amendment speech rights" and is not impermissibly vague. ROA.440, 443. The court further justified the statute as a means to "effectively set[] the maximum price for credit-card purchases as the posted price." The court then clothed the statute under the cloak of the "state's police power to regulate business" to avoid applying the appropriate level of scrutiny and thereby finding the statute unconstitutional. ROA.440, 441. However, the law is clear: when a statute makes liability "depend[] on what [people] say," "it regulates speech on the basis of its content" and must satisfy the First Amendment. *Holder v. Humanitarian Law* Project, 561 U.S. 1, 27 (2010). Thus, the district court's decision must be reversed.

(explaining that something "cannot simultaneously be non-communicative" and yet "pose the risk of communicating a misleading message"). None of the Court's justifications come close to satisfying that standard.

Even if the statute were necessary to "set a maximum price" for credit card purchases, which is it not, that objective can be achieved by far less restrictive means. By virtue of the language the statute prohibits merchants from utilizing, consumers are provided a one-sided perspective on the surcharge[33] Even assuming however, that the lower court's concern is grounded in reality, the no-surcharge rule is dismally crafted (and hugely overbroad) if its aim is in fact to protect consumers from merchants who could advertise a higher sticker price.[34] Moreover, as a practical matter, the nationwide settlement agreement with credit-card companies obviates this concern by requiring the truthful and prominent disclosure of surcharge information to consumers. *See In re Payment Card Interchange Fee And Merchant Discount Antitrust Litig.*, --- F. Supp. 2d ---, 2013 WL 6510737, at

[33] This is further supported by the fact that every major consumer advocacy organizations, including Consumers Union and Consumer Federation of America, have long opposed state no-surcharge laws. *See* JA 103-104; *see also* Molotsky, *Extension of Credit Surcharge Ban*, N.Y. TIMES, Feb. 29, 1984, at D12 (quoting Senator William Proxmire, stating in debate on the Senate floor that "[n]ot one single consumer group supports the proposal to continue the ban on surcharges.").

[34] A related defense of the no-surcharge rule argues that two-tiered pricing interferes with consumers' ability to comparison shop. There is no logic to this argument as a justification for disallowing surcharging while permitting discounts as "there is no reason to think that a comparison of maximum prices (allowing discounts, not surcharges) is any better than a comparison of minimum prices (allowing surcharges, not discounts)." Levitin, *supra* note 5, at 1383. Because discounts and surcharges are mathematically equivalent, allowing one and not the other relies on an impermissible "underestimation of the public," *Bates*, 433 U.S. at 375, especially if merchants are required to disclose their pricing structure.

*21 (E.D.N.Y. 2013). Putting aside the settlement, however, a far less restrictive and more effective approach to keeping merchants from abusing two-tiered pricing would be to simply institute disclosure rules. Disclosure requirements like those proposed by the Federal Reserve Board would entirely protect consumers from abusive surcharging.[35] *See Cash Discount Act, 1981: Hearings on S. 414 Before the Senate Banking Comm.*, 97th Cong., 1st Sess. 10 (Feb. 18, 1981) (proposing "a very simple rule": that both surcharges and discounts be allowed and "the availability of the discount or surcharge be disclosed to consumers."). Thus, the nationwide settlement and adequately advertised credit card surcharges entirely dispose of concerns that consumers would be harmed by misleading prices.

Moreover, the state's interests would be better served by ensuring that consumers have access to complete and accurate information. In fact, common sense dictates "that people will perceive their own best interest if only they are well enough informed, and that the best means to that end is to open the channels of communication rather than to close them." *Virginia Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748, 770 (1976). In any case, credit card companies have far overstated the danger posed by surcharging because

[35] *See* S. Rep. No. 97023, at 11–12 (1981); Council Directive 98/6, art. 3, 1998 O.J. (L 80) 28 (EC) (directing member states to adopt regulations requiring merchants to indicate both selling price and unit price for all covered products); *see also* Levitin, *supra* note 5, at 1384.

the marketplace, through consumer reactions, will naturally discipline merchants who would seek to abuse the right to describe a price difference as a surcharge. As a matter of fairness, allowing customers to weigh their preferences based on the form of payment employed is far more important than the court's desire for a consistent price framing mechanism.

IV. THE EXISTENCE OF NETWORK EFFECTS DOES NOT JUSTIFY THE NO-SURCHARGE LAW.

In analyzing the no-surcharge law, economic theorists have vastly overemphasized the importance of "network effects"—the idea that credit cards increase in value based on the number of merchants and consumers who use them—in analyzing the law's impact on consumer welfare.[36] These theories can only be employed as a defense of the no-surcharge rule under the woefully myopic belief that positive network effects are the *only* consequence of increased credit card spending. In fact, if surcharging caused a decrease in credit card usage, it undoubtedly would increase overall consumer welfare because: first, some transactions will likely be diverted to other payment systems, like "PIN debit" which have their own network effects that will offset "harm" to credit card networks; second, credit card usage has specific externalities which undermine the facile assumption that more credit card debt means more consumer welfare.

[36] *See* Levitin, *supra* at note 5, at 1385–90.

A. Benefits to Consumers In Other Networks, Like Debit Card Users, Along With Reduction in Interchange Fees, Will More than Offset the Welfare Costs of Decreased Credit Card Usage.

Surcharging will create genuine competition between payment systems, benefiting debit card users and driving down merchant fees for everyone. Many other payment systems are subject to network effects, meaning that the diverted credit card usage would create comparable welfare gains in other networks. For example, debit card usage is highly cross elastic with credit card usage,[37] and the marginal loss to credit card users would be offset by the benefits to debit users. In fact, for newer payment systems adoption matters a great deal more. By the time networks are as well-established and mature as credit cards, "the adoption and usage externality has become less important."[38] The qualities that most consumers cite as their reasons for using credit cards – convenience, security from theft, widespread acceptance, speed at checkout – are fully replaceable by new payment systems like debit cards, at *half* the cost.[39]

---

[37] *See* Jonathan Zinman, *Debit or Credit?* 19 (Aug. 2007) (unpublished manuscript), *available at* http://www.dartmouth.edu/~jzinman/Papers/Zinman_DebitorCredit_aug08.pdf.

[38] Zhu Wang, *Market Structure and Credit Card Pricing: What Drives Interchange?*, 28 INT'L J. OF INDUS. ORG. 86, 95 (2010) *available at* http://www.frbatlanta.org/news/CONFEREN/08payments/08payments_Wang.pdf.

[39] David S. Evans & Richard Schmalensee, INTERCHANGE FEES IN CREDIT AND DEBIT CARD INDUSTRIES, PROCEEDINGS OF THE 2005 FEDERAL RESERVE BANK OF KANSAS CITY CONFERENCE, *The Economics of Interchange Fees and Their Regulation: An Overview,* 31 (2005). Many debit cards actually offer superior (continued…)

The state has no legitimate interest in artificially sparing credit cards from free and open competition with other payment systems. If the no-surcharge law is necessary to maintain credit cards' position vis-à-vis other payment systems, it is preserving a market failure that substantially harms consumers. The Supreme Court has rejected state attempts to restrict advertising based on the "fear that people would make bad decisions if given truthful information." *Thompson v. W. States Med. Ctr.*, 535 U.S. 357, 374; *Bates*, 433 U.S. at 364 (holding that commercial speech "performs an indispensable role in the allocation of resources in a free enterprise system"). In fact, the most likely and significant outcome of allowing merchants to frame the cost of credit as a "surcharge" rather than a "discount" is a reduction in interchange fees as credit cards are forced to compete on price with other payment systems. By barring merchants from effectively signaling differential costs of payments, the "no surcharge rules increase the price of all other payment system to match the price of credit cards,"[40] explaining why

---

security through the use of pin systems and because debit card fraud does not affect a consumer's credit report, whereas credit card fraud does. Levitin, *supra* note 5, at 1387.

[40] Levitin, *supra* note 5, at 1358 (citing Joseph Farrell, *Efficiency and Competition Between Payment Instruments,* 5 REV. NETWORK ECON. 26, 31 (2006)). Under current common contract terms, no credit card issuer would benefit from lifting the restraints unilaterally because the other, presumably more costly, credit card companies would still be protected by their own no surcharge rules. *See* Levitin, *supra* note 5, at 1359.

"interchange fees in the United States are more than double those in some other countries (Australia, EU cross-border, and the UK)."[41] Australia's relatively recent ban on no-surcharge rules immediately led to increased debit usage, while the average MasterCard and Visa interchange rates fell by nearly half across the board. Significantly, it also led to increased volume on its network.[42] Moreover, even without no-surcharge rules, credit card companies continue to profit in Finland, the Netherlands, Portugal, Sweden, the United Kingdom, Switzerland, and Australia.[43] In fact, MasterCard voluntarily rescinded its own no-surcharge rule for Europe in 2005.[44] In light of these real world examples, it is impossible to say with a straight face that no-surcharge rules really help consumers. On balance, the effects the decreased network effects for credit users are dwarfed by the gains in efficient market allocation. The no-surcharge law may be vital to the preservation of supracompetitive profit margins for credit card companies, but there is no

---

[41] Stuart E. Weiner & Julian Wright, *Interchange Fees in Various Countries: Developments and Determinants*, 4.4 REV. OF NETWORK ECON. 299 (2005) *available at http://www.academia.edu/3095968/Interchange_Fees_in_Various_Countries_Developments_and_Determinants*.

[42] Levitin, *supra* note 2, at 61.

[43] Levitin, *supra* note 5, at 1389. For an overview of global regulation of interchange fees, *see* Terri Bradford & Fumiko Hayashi, FEDERAL RESERVE BANK OF KANSAS CITY PAYMENTS SYSTEM RESEARCH BRIEFING, *Developments in Interchange Fees In the United States and Abroad*, (Apr. 2008), http://www.kansascityfed.org/publicat/psr/briefings/psr-briefingApr08.pdf.

[44] *Surcharging in Europe*, Nilson Rep., Sept. 2004, at 6–7.

economic theory that can twist this interest into a pro-consumer justification of the law.

B. Overconsumption of Credit Card Debt Causes Uniquely Harmful Social Externalities.

A supposedly pro-consumer defense of the no-surcharge law based on spurring expanded use of credit cards is radically out of step with the facts of credit card debt consumption. Credit card debt in America was $870 billion by May of 2012.[45] Moreover, "Americans racked up nearly $48 billion in new credit card debt in 2011, 424 percent more than what they charged in 2010, and 577 percent more than in 2009.[46] Although total outstanding credit rose only about $4 billion, that number was largely offset by the magnitude of consumer defaults—*$44.2 billion worth.*"[47] As a result of a phenomenon unique to credit card debt, consumers consistently underestimate both the credit debt they already hold, and the costs they will eventually incur. In 2011, Americans held an average of $7,134 in credit card debt per household, but reported themselves as having an average of

[45] The Associated Press, *Consumers Take on More Debt*, N.Y. TIMES, (Jul. 9, 2012), *available at* http://www.nytimes.com/2012/07/10/business/credit-card-debt-climbed-by-8-million-in-may.html?_r=0.
[46] Meg Handly, *Consumers Still Buried In Credit Card Debt*, U.S. NEWS AND WORLD REPORT (Mar. 12, 2012) http://www.usnews.com/news/articles/2012/03/12/consumers-still-buried-in-credit-card-debt (emphasis added).
[47] Handly, *supra* note 44.

$2000 less.[48] Credit card usage is also causally linked to personal bankruptcy, and credit card companies target bankrupt and near-bankrupt households with predatory offers.[49] Following the ban on no-surcharge rules, Australia saw a 43% decrease in the gross of credit card debt.[50] A comparable reduction in the growth of American credit card debt, far from being a cost of surcharging, would be a highly desirable side effect.

CONCLUSION

For the foregoing reasons, amici Consumer Action, National Association of Consumer Advocates, National Consumers League, U.S. PIRG and TexPIRG urge this Court to reverse the District Court's decision in its entirety.

Dated: June 16, 2015

Respectfully submitted,

/s/ Daniel A. Small
Daniel A. Small

---

[48] Meta Brown et al., FEDERAL RESERVE BANK OF NEW YORK, *Do We Know What We Owe? A Comparison of Borrower- and Lender-Reported Consumer Debt*, Oct. 2011, *available at http://www.newyorkfed.org/research/staff_reports/sr523.pdf*; *see also* Oren Bar-Gill, *Seduction by Plastic,* 98 Nw. U. L. Rev. 1373, 1396–402 (2004); Levitin, *supra* note 2, at 50–52 (describing various studies outlining consumer under appreciation of the cost of credit).

[49] *See* Teresa A. Sullivan, Elizabeth Warren, Jay Lawrence Westbrook *Credit Cards* at 108, THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT, Yale University Press (2000), (outlining the connection between credit card usage and bankruptcy); Levitin, *supra* note 2, at 43.

[50] Levitin, *supra* note 12, at 137.

Benjamin D. Brown
COHEN MILSTEIN SELLERS
& TOLL PLLC
1100 New York Avenue
Suite 500
Washington, D.C. 20005
Telephone: (202) 408-4600
dsmall@cohenmilstein.com
bbrown@cohemilstien.com

CERTIFICATE OF COMPLIANCE WITH RULE 32(a)(7)

I hereby certify that my word processing program, Microsoft Word, counted 5,811 words in the foregoing brief, exclusive of the portions excluded by Rule 32(a)(7)(B)(iii).

/s/ Daniel A. Small
Daniel A. Small

June 16, 2015

CERTIFICATE OF SERVICE

I hereby certify that on June 16, 2015, I electronically filed the foregoing Amicus Brief with the Clerk of the Court of the U.S. Court of Appeals for the Fifth Circuit by using the Appellate CM/ECF system. All participants are registered CM/ECF users, and will be served by the Appellate CM/ECF system.

/s/ Daniel A. Small
Daniel A. Small