

**IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION**

LYNN ROWELL d/b/a/ BEAUMONT §
GREENERY; §
MPC DATA AND §
COMMUNICATIONS, INC.; §
MICAH COOKSEY; §
NXT PROPERTIES, INC.; §
MARK HARKEN; §
MONTGOMERY CHANDLER, INC.; §
PAULA COOK; §
TOWNSLEY DESIGNS, LLC; and §
SHONDA TOWNSLEY, §

Plaintiffs §

v. §

CIVIL ACTION NO. _____

GREG ABBOTT, in his official capacity §
as Attorney General of the §
State of Texas; and §
LESLIE L. PETTIJOHN, in her official §
capacity as Commissioner of the Office §
of Consumer Credit Commissioner §
of the State of Texas, §

Defendants §

PLAINTIFFS' ORIGINAL COMPLAINT

TO THE HONORABLE UNITED STATES DISTRICT COURT:

The nine merchants named above seek a declaration that the Texas no-surcharge law, TEX. FIN. CODE § 339.001, is unconstitutional and an injunction preventing the State of Texas from enforcing the law against them.

Introduction

1. Every time a consumer uses a credit card to make a purchase, the merchant incurs a fee—known colloquially as a “swipe fee.” Swipe fees are typically passed on to all consumers in the form of higher prices for goods and services. Both state

and federal law, however, permit merchants to pass swipe fees on to only those consumers who pay with credit cards. Merchants may do so by charging two different prices depending on how the consumer pays: a higher price for using a credit card, and a lower price for using other payment methods (cash, a personal check, or a debit card). But, in Texas, merchants may engage in dual pricing only if they communicate the difference between the cash price and the credit price using the right *language*: The Texas no-surcharge law, Tex. Fin. Code § 339.001, allows merchants to offer “discounts” for using cash or a debit card, yet makes it illegal to impose “surcharges” for using a credit card—even though the conduct in both cases (the use of dual pricing) is the same.

2. This “virtually incomprehensible distinction between what a vendor can and cannot tell its customers” has already caused one federal court to strike down New York’s indistinguishable statute as an impermissible restriction on free speech and as unconstitutionally vague. *Expressions Hair Design v. Schneiderman*, --- F. Supp. 2d ---, No. 13 Civ. 3775, 2013 WL 5477607, *1 (S.D.N.Y. Oct. 3, 2013). And the only other federal court to consider state no-surcharge laws has signaled its agreement, calling the statutes “anti-consumer” and “irrational,” and finding “good reason to believe” that the remaining no-surcharge laws will be overturned. *In re Payment Card Interchange Fee & Merchant Discount Antitrust Litig.*, --- F. Supp. 2d ---, No. 05-MD-1720, 2013 WL 6510737, *19-*20 (E.D.N.Y. Dec. 13, 2013). Texas’s no-surcharge law is no different. Like New York’s, it violates the First Amendment to the U.S. Constitution and is unconstitutionally vague.

Jurisdiction

3. This Court has jurisdiction under 28 U.S.C. §§ 1331 and 1343(a)(3). Venue is proper in the Western District of Texas under 28 U.S.C § 1391(b).

Parties

4. Plaintiff Lynn Rowell owns and operates Beaumont Greenery, a landscape and garden business in Beaumont, Texas, as a sole proprietorship. He is responsible for the day-to-day management of the business. When a customer makes a purchase using a credit card, Beaumont Greenery pays roughly 3% of the total amount in swipe fees. For large landscaping projects and bulk sales, these fees can be especially significant—totaling hundreds of dollars for a single transaction and sharply cutting into the company’s profit margin.

5. A few years ago, one large sale prompted Beaumont Greenery to consider how it could better inform its customers of the cost of credit, so they would switch to cheaper payment methods. The company came up with an idea: It would put up a sign telling customers that it charges an additional fee if they pay with credit. Beaumont Greenery was forced to abandon this idea, however, when an American Express representative explained that the sign would violate the credit-card company’s contractual rules, which prohibited credit-card “surcharges.” Now that American Express and the other major credit-card companies have agreed to allow surcharges, Beaumont Greenery would like to put up its sign. Yet it cannot do so because of the Texas no-surcharge law.

6. That law gives the company two options: The first is to charge two different prices for its products and services—a lower price to customers paying with cash, check, or debit card and a higher price to those paying with a credit card—but to express the difference between them as a “discount” for cash rather than a “surcharge” for credit. The problem with this option is that Beaumont Greenery does not want to describe its prices in that way. It does not want to tell its customers that the credit-card price is the

“regular” price, and the cash or debit-card price is the regular price with a “discount.” That would make the company’s prices look higher than they are without conveying to customers that the price difference is attributable solely to the cost of credit—the very message Beaumont Greenery wants to communicate. Beaumont Greenery would rather say that the cash price is the “regular” price, and the credit price is the regular price with an “extra” charge for using a credit card. But that way of explaining the price difference is banned in Texas.

7. Beaumont Greenery’s second option is almost as bad as its first: It could continue offering no dual pricing at all, even though dual pricing is permitted by law. The problem with this option is that, by charging customers the same price regardless of what payment method they use, Beaumont Greenery is forced to raise its prices across the board to account for the cost of credit. This keeps customers in the dark about the cost of credit, and provides them no incentive to switch to a cheaper payment method. Over time, this lack of information allows credit-card companies to increase swipe fees with near impunity, forcing Beaumont Greenery to raise its prices further.

8. The company has decided to refrain from dual pricing because Texas law leaves it little choice. Not only does the law ban the most effective way of describing a dual-pricing policy—as a “surcharge” for using a credit card—the law is so vague about what else it prohibits that Beaumont Greenery is afraid to have any dual pricing at all, lest it accidentally subject itself to liability. If the company offered dual pricing, could it tell customers that “credit costs more”? Or would it have to say that “cash costs less”? Beaumont Greenery is not confident that it could instruct its employees on the difference between a “surcharge” and a “discount,” which even its owner does not fully understand, and then constantly monitor its employees to make sure each one is sticking to the script.

Rather than risk breaking the law to say something that it believes is only marginally effective at communicating its message, Beaumont Greenery stays away from dual pricing altogether.

9. Plaintiff MPC Data and Communications, Inc., better known as Texas Computer Associates, is a computer-networking and telephone-systems company in Beaumont, Texas. It accepts all major credit-card brands and pays between 1.5% and 3% of the total amount of each credit transaction in swipe fees. For a small business like Texas Computer, these fees make a big difference.

10. Seeking to reduce swipe fees, Texas Computer has occasionally experimented with dual pricing. When one customer recently wanted to pay for a large sale with a credit card, Texas Computer explained that the customer would be charged an additional fee for using credit. But the company was forced to stop communicating the cost of credit in this way when it was notified that doing so was a “surcharge” in violation of the credit-card companies’ contractual rules.

11. Even though those rules are now changing, Texas Computer still cannot express the cost of credit as an additional fee because of Texas’s no-surcharge law. Because of that law, Texas Computer does not currently engage in dual pricing, even though it would like to (and is allowed to). This means that swipe fees get passed on to all of its customers, cash and credit-card users alike, in the form of higher prices. And because these fees are kept hidden, customers are not made aware of them and have no disincentive to use credit—in fact, they are encouraged to use credit cards because of the benefits that they offer—which raises fees even higher.

12. Texas Computer does not offer dual pricing for two reasons. First, the company does not want to describe the difference between the credit price and cash price

as a “discount,” which is what it would have to say under the Texas no-surcharge law. Texas Computer believes that this way of framing prices would be ineffective because it would not inform customers of the true cost of credit, would not provide them with a strong incentive to use a cheaper payment method, and would make regular prices look higher than they are. It would be much more effective for Texas Computer to label its cash price as the “regular” price, while explaining to customers that they will pay an extra charge for credit because of the high fees imposed by credit-card companies. But Texas Computer cannot use those words because of the no-surcharge law.

13. Second, Texas Computer does not offer dual pricing because the no-surcharge law is unclear about what speech is lawful, and what speech is banned. Texas Computer does not fully understand the line drawn by Texas law, nor is it sure that its employees could frame the company’s prices in a lawful way in daily interactions with customers. It is easier for Texas Computer to avoid charging different prices so that it does not get into trouble over how it truthfully describes its prices to its customers.

14. Plaintiff Micah P. Cooksey is the owner of Texas Computer and is responsible for its day-to-day management.

15. Plaintiff NXT Properties, Inc., better known as Storage Depot, is a self-storage and truck-rental facility in Orange, Texas. Storage Depot pays roughly 3% per credit-card transaction in swipe fees. This amounts to nearly one thousand dollars per month in fees—a significant monthly expense for the company. Storage Depot would like to bring these fees to the attention of its customers by telling them that there is an additional charge for paying by credit. But it does not do so because of the Texas no-surcharge law.

16. Nor does Storage Depot offer dual pricing. It does not do so because of the law’s prohibition on speech and also because of its vagueness. Storage Depot would like to communicate the price difference to its customers as a “surcharge” for credit—not a “discount” for cash or debit, which would make prices appear higher than they are—because the company believes that this would most effectively convey the costs of credit to its customers. The company also believes that informing customers that there is a credit-card “surcharge” because of high swipe fees—fees that those customers are not currently made aware of—would offer customers a stronger incentive to switch to cheaper forms of payment than telling them that there is “discount” for paying with cash. But Texas’s no-surcharge law doesn’t give the company that option. And the law is so vague about what exactly it prohibits that Storage Depot is reluctant to offer any dual pricing at all out of fear that it would accidentally break the law.

17. If it were legal, Storage Depot would tell its customers that it offers one low base price for each of its products and that there is an additional fee if a customer chooses to pay with a credit card. Storage Depot believes that this truthful speech would benefit both the company and its customers by giving customers the information they need to make the best decisions about how to pay for their purchases, and by allowing the company to keep prices down for all customers and therefore improve its bottom line.

18. Plaintiff Mark Harken is the owner, president, and founder of Storage Depot and is responsible for its day-to-day management.

19. Plaintiff Montgomery Chandler, Inc., is a coin and bullion dealer in Silsbee, Texas. About half of its sales are paid for by credit card. On those sales, Montgomery Chandler pays between 2.6% and 3.5% in swipe fees. These fees have steadily increased over time, are not negotiable, and cut into the company’s already slim

profit margins. Montgomery Chandler would like to communicate the cost of credit to customers by calling it a “surcharge,” which the company believes would be effective at getting them to reduce credit use. But Texas’s no-surcharge law bars the company from using that label.

20. Because of Texas’s law, Montgomery Chandler does not currently engage in dual pricing. It does not do so for the same reasons as the other merchants: (1) because the law bans the company’s most effective way of conveying to its customers the true cost of credit, and (2) because the law’s vagueness leaves the company uncertain as to whether it could implement a dual-pricing system in a lawful way. If it were permissible, Montgomery Chandler would call the cash price the “regular” price and say that it charges an additional amount for credit-card purchases to account for swipe fees.

21. Plaintiff Paula Cook is the owner and president of Montgomery Chandler and is responsible for its day-to-day management.

22. Plaintiff Townsley Designs, LLC, is an event design and production company based in Cedar Park, Texas. It typically pays around 3% per credit transaction in swipe fees, and sometimes even more. Over the years, an increasing percentage of the company’s sales are paid for with a credit card, to the point that nearly half of its gross annual sales now incur a swipe fee. Townsley Designs wants to offer a dual-pricing system, but it will do so only if it can communicate the price difference as a “surcharge” for using credit (which the company believes is the best way to convey the cost of credit) and only if the law is clear about what it permits (and what it prohibits). Texas’s no-surcharge law prevents both of these conditions from being satisfied.

23. Plaintiff Shonda Townsley is co-owner of Townsley Designs and is responsible for its day-to-day management.

24. Defendant Greg Abbott is the Attorney General of Texas and is responsible for enforcing the laws of the state. Defendant Leslie L. Pettijohn is the Commissioner of the Office of Consumer Credit Commissioner (OCCC), the Texas agency with exclusive authority to enforce the state’s no-surcharge law. They are sued in their official capacities.

Factual Background

25. Americans pay some of the highest swipe fees in the world—seven or eight times those paid by Europeans, according to estimates by the Merchants Payments Coalition. The main reason swipe fees are so high is that they are kept hidden from consumers, who decide which payment method to use and thus determine whether a fee will be incurred in the first place. According to one survey, about 41% of American credit-card users are completely unaware that merchants are charged fees to process credit-card transactions. Although merchants are allowed to charge consumers more for using credit than for using cash, merchants cannot effectively communicate that added cost because Texas and other states force them to call it a “discount” for cash rather than a “surcharge” for credit.

26. Texas’s no-surcharge law makes it unlawful for any merchant, “[i]n a sale of goods or services,” to “impose a surcharge on a buyer who uses a credit card for an extension of credit instead of cash, a check, or a similar means of payment.” TEX. FIN. CODE § 339.001(a). Texas’s no-surcharge law does *not*, however, outlaw dual pricing. As the OCCC has explained, merchants are permitted “to extend a discount to a buyer who pays with cash instead of a credit card.” Opinion Letter from Sealy Hutchings, General Counsel of the OCCC, to Jason Boatright, Chair of the Opinion Committee, Office of the Attorney General (Nov. 8, 2011). Under Texas law, in other words, “a merchant may

offer a cash customer a discount, but may not impose a surcharge on a credit card customer.” *Id.* That is, a merchant may “have two prices (one for cash and one for credit) as long as” the merchant tells customers that the “credit price is its regular price.” Email from Matthew Nance, Assistant Attorney General, Office of Consumer Credit Commissioner, to Don Beckham (June 25, 2012).

27. Until 2013, Texas’s no-surcharge law was effectively redundant because credit-card companies imposed similar speech prohibitions in their contracts with merchants. But after federal antitrust litigation caused the three dominant credit-card companies (Visa, MasterCard, and American Express) to agree to change their contracts to remove their no-surcharge rules, Texas’s law took on added importance. It is now the only thing keeping the plaintiffs from saying what they would like: that they impose a “surcharge” for using credit because credit costs more.

I. Why labels matter: the communicative difference between “surcharges” and “discounts”

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

29. But labels can matter. “[T]he frame within which information is presented can significantly alter one’s perception of that information, especially when one can perceive the information as a gain or a loss,” as with the price difference between using cash and using credit. Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 Harv. L. Rev. 1420, 1441 (1999). This is largely

because of a well-known cognitive phenomenon called “loss aversion,” which refers to people’s tendency to let “changes that make things worse (losses) loom larger than improvements or gains” of an equivalent amount. Daniel Kahneman, Jack L. Knetsch, & Richard H. Thaler, *Anomalies: The Endowment Effect, Loss Aversion, and Status Quo Bias*, 5 J. Econ. Persp. 193, 199 (1991). Put more simply: “people have stronger reactions to losses and penalties than to gains.” Adam J. Levitin, *The Antitrust Super Bowl: America’s Payment Systems, No-Surcharge Rules, and the Hidden Costs of Credit*, 3 Berkeley Bus. L.J. 265, 280 (2006).

30. Because of this, “[c]onsumers react very differently to surcharges and discounts,” even though they present the exact same pricing information. *Id.* Consumers are more likely to respond to surcharges (which are perceived as *losses* for using credit) than to discounts (which are perceived as *gains* for not using credit). *Id.* Research shows just how wide this gap is. In one study, 74% of consumers had a negative or strongly negative reaction to credit surcharges, while fewer than half had a negative or strongly negative reaction to cash discounts. That difference—the difference in how the same pricing information is understood by consumers—influences their behavior, making “surcharges” a much more effective way to communicate the costs of credit to consumers.

31. The effectiveness of surcharges is why the plaintiffs in this case seek to impose them: surcharges inform consumers of the costs of credit, letting consumers decide for themselves whether credit’s benefits outweigh its costs. That exchange of information creates meaningful competition, which in turn drives down costs—as demonstrated by price-transparency reforms in Europe and Australia. If consumers are made aware of swipe fees and determine that they are too high, consumers will use a different payment method, and banks and credit-card companies will have to lower their fees to attract

more business. Indeed, in Australia, where regulators in 2003 allowed complete transparency of price information and merchants have responded with surcharges, swipe fees have greatly declined.

32. But when the government prohibits framing the added cost of credit as a “surcharge,” as Texas has done, merchants lose their most effective means of informing consumers of the high costs of credit. Moreover, because the dividing line between what constitutes a “surcharge” and what constitutes a “discount” is so blurry, many merchants (including the plaintiffs in this case) do not even attempt to offer dual pricing, even though the law allows it, to avoid accidentally subjecting themselves to liability. And many other merchants falsely believe that they may not offer any dual pricing at all. The upshot, then, is that merchants end up passing on swipe fees to *all* consumers by raising the prices of goods and services across the board. This means that consumers are unaware of how much they pay for credit and have no incentive to reduce their credit-card use because they will pay the same price regardless. As a result, swipe fees have soared.

33. Swipe fees thus function as an invisible tax, channeling vast amounts of money from consumers to some of the nation’s largest banks and credit-card companies. Because cash and credit purchasers both pay this tax, swipe fees are also highly regressive: low-income cash purchasers subsidize the cost of credit cards, while enjoying none of their benefits or convenience. According to Federal Reserve economists, “[b]y far, the bulk of [this subsidy] is enjoyed by high-income credit card buyers,” who receive an average of \$2,188 every year, paid disproportionately by poor and minority households. The result is a regime in which food-stamp recipients are subsidizing frequent-flier miles.

34. For these reasons, numerous prominent economists and consumer advocates—from Joseph Stiglitz to Elizabeth Warren—have opined that no-surcharge policies are bad for consumers and hurt competition.

II. The credit-card industry’s concerted efforts to prevent merchants from communicating the costs of credit as “surcharges”

35. The invisibility of swipe fees is no accident. It is the product of concerted efforts by the credit-card industry over many decades to ensure that merchants cannot communicate to consumers the added price they pay for using credit. Over the years, the industry has succeeded, both through contractual provisions and legislative measures, to silence merchants’ attempts to call consumers’ attention to the true costs of credit.

The industry’s early ban on differential pricing ends

36. In the early days of credit cards, any attempt at differential pricing between credit and non-credit transactions was strictly forbidden by rules imposed on merchants in their contracts with credit-card companies. That changed in 1974 after two important developments. *First*, Consumers Union sued American Express on the ground that its contractual ban on differential pricing was an illegal restraint on trade. Rather than face the prospect that federal courts would mandate full price transparency, American Express almost immediately settled the suit by agreeing to allow merchants to provide consumers with differential price information.

37. *Second*, Congress then enacted legislation protecting the right of merchants to have dual-pricing systems. Congress amended the Truth in Lending Act to provide that “a card issuer may not, by contract, or otherwise, prohibit any such seller from offering a discount to a cardholder to induce the cardholder to pay by cash, check, or similar means rather than use a credit card.” Pub. L. No. 93, § 495, 88 Stat. 1500 (1974).

The credit-card industry shifts its strategy to labeling

38. The 1974 amendments were initially considered a victory for consumers. But the credit-card industry, seizing on Congress's use of the word "discount," soon shifted its focus to the way merchants could *label* and *describe* such pricing to consumers. Aware that how information is presented to consumers can have a huge impact on their behavior—and that many merchants would avoid dual pricing altogether if "surcharges" were outlawed—the credit-card lobby "insist[ed] that any price difference between cash and credit purchases should be labeled a cash discount rather than a credit card surcharge." Amos Tversky & Daniel Kahneman, *Rational Choice and the Framing of Decisions*, 59 J. Bus. S251, S261 (1986).

The credit-card industry's labeling strategy achieves short-lived success at the national level

39. In 1976, after two years of lobbying Congress to impose the credit-card industry's preferred speech code, the industry succeeded in getting Congress to enact a temporary ban on "surcharges," despite the authorization for "discounts." *See* Pub. L. No. 94-222, 90 Stat. 197 ("No seller in any sales transaction may impose a surcharge on a cardholder who elects to use a credit card in lieu of payment by cash, check, or similar means."). This controversial measure set the stage for a series of battles over renewal of the ban, culminating in an intense political debate in the mid-1980s that pitted both the Reagan Administration and consumer groups against the credit-card industry.

40. With the "surcharge" ban set to expire in 1981, the federal government and consumer advocates registered the impact that it had on consumers' and merchants' behavior. The Chairman of the Federal Trade Commission, writing in opposition to extending the law, recognized that the "surcharge" label drives home the true marginal

cost of a credit transaction to the consumer. S. Rep. 97-23, at 11-12. Although “a discount and a surcharge are equivalent concepts,” he remarked, “one is hidden in the cash price and the other is not,” meaning that a ban on “surcharges” prohibited merchants from disclosing to their customers the true cost of credit. *Id.* at 10.

41. The Federal Reserve Board held a similar view. One member—presenting the Board’s unanimous opposition to the surcharge ban’s extension—pointed out “the obvious difficulty in drawing a clear economic distinction between a permitted discount and a prohibited surcharge.” *Cash Discount Act, 1981: Hearings on S. 414 Before the Subcomm. On Consumer Affairs of the Senate Comm. On Banking, Housing, & Urban Affairs, 97th Cong., 1st Sess. 9* (Feb. 18, 1981) (Nancy Teeters, Federal Reserve Board). “If you just change the wording a little bit, one becomes the other.” *Id.* at 22. The Board thus proposed “a very simple rule”: that both surcharges and discounts be allowed, and “that the availability of the discount or surcharge be disclosed to consumers.” *Id.* at 10.

42. Every major consumer advocacy organization agreed, and urged Congress to let the ban lapse and allow surcharges. One consumer advocate testified that the difference between surcharges and discounts “is merely one of semantics, and not of substance.” *Id.* at 98 (Ellen Broadman, Consumers Union). But “the semantic differences are significant,” she explained, because “the term ‘surcharge’ makes credit card customers particularly aware that they are paying an extra charge,” whereas “the discount system suggests that consumers are getting a bargain, and downplays the truth.” *Id.* Another advocate put it more pithily: “one person’s cash discount may be another person’s surcharge.” *Id.* at 90 (Jim Boyle, Consumer Federal of America). “Removing the ban on surcharges,” he explained, “is an important first step” to “disclos[ing] to consumers the full” cost of credit so that they can “make informed judgments.” *Id.* at 92.

43. On the other side of the debate, American Express and MasterCard “wholeheartedly” and “strongly” supported the ban, even though, from a “mathematical viewpoint,” “there is really no difference between a discount for cash and a surcharge for credit card use.” *Id.* at 43 (Hugh H. Smith, American Express); *id.* at 55 (Amy Topiel, MasterCard). And the big banks, like the credit-card giants, supported treating “surcharges” and “discounts” differently because a surcharge “makes a negative statement about the card to the consumer.” *Id.* at 32 (Peter Hood, American Bankers Association). Surcharges, a banking lobbyist openly explained, “talk against the credit industry.” *Id.* at 60. Congress ultimately gave in to industry lobbying and renewed the ban for an additional three years. Pub. L. 97–25, 95 Stat. 144 (1981).

44. In 1984, the no-surcharge law was again set to expire. Senator William Proxmire of Wisconsin, one of the ban’s chief opponents, cut to the chase: “Not one single consumer group supports the proposal to continue the ban on surcharges,” he observed. “The nation’s giant credit card companies want to perpetuate the myth that credit is free.” Irvin Molotsky, *Extension of Credit Surcharge Ban*, N.Y. Times, Feb. 29, 1984, at D12. The credit-card industry, acutely conscious of the threat that merchants’ disclosure of credit’s true cost posed to its business model, responded by unleashing a massive lobbying campaign to oppose ending the ban. Stephen Engelberg, *Credit Card Surcharge Ban Ends*, N.Y. Times, Feb. 27, 1984, at D1. One senior vice president of Shearson/American Express remarked in 1984 that his company had been opposing ending the ban for eight years. He observed that consumers do not write angry letters to credit-card companies about cash discounts, but do complain about surcharges. *Id.* He concluded that ending the ban “could potentially hurt the image of” credit cards, revealing that the industry viewed its legislative efforts as playing a key role in dictating

the perception of credit cards among consumers. *Id.* This time, the industry’s efforts failed, and the ban lapsed in 1984. Levitin, *Priceless?*, 55 UCLA L. Rev. at 1381.

45. A 1981 report of the Senate Banking Committee, prepared as part of the law’s initial renewal, stressed the law’s role in regulating how a merchant could frame a dual-pricing system. The Committee observed that “while discounts for cash and surcharges on credit cards may be mathematically the same, their practical effect and the impact they may have on consumers is very different.” S. Rep. 97-23, at 3. The no-surcharge law thus effectively set forth a speech code, requiring that merchants label their prices in the way that best hid the costs of credit and most enabled the credit-card companies to take advantage of the framing effect: by advertising the credit price as the “regular” price, and the cash price as a “discount” from that price.

46. Furthermore, the vague distinction between “discounts” and “surcharges,” and the risk of inadvertently describing a dual-pricing system in an unlawful way, led merchants to steer clear of such systems. In an editorial in *The New York Times*, Senator Christopher Dodd of Connecticut, a proponent of allowing surcharges, noted that “many merchants are not sure what the difference between a discount and a surcharge is and thus do not offer different cash and credit prices for fear they will violate the ban on surcharges.” Sen. Christopher J. Dodd, *Credit Card Surcharges: Let the Gouger Beware*, N.Y. Times, Mar. 12, 1984, at A16. *See also* Carol Krucoff, *When Cash Pays Off*, Wash. Post, Sept. 22, 1981 (describing consumer activist who argued that merchants have not offered cash discounts because “the regulations have been so complicated. Smaller business people, who are most likely to offer them, may have been intimidated by the fear it could be viewed as an illegal surcharge.”); Engelberg, *Credit Card Surcharge Ban Ends*, at D1 (“A House aide said that one explanation for the relative unpopularity of cash discounts is

that retailers, aware that surcharges on credit purchases are illegal, have erroneously assumed that discounts are not permitted.”).

**The credit-card industry lobbies the states to enact
no-surcharge laws and adopts contractual no-surcharge rules**

47. After the controversial federal ban expired, the credit-card industry briefly turned to the states, convincing fewer than a dozen (including Texas) to enact no-surcharge laws of their own. In an early instance of the phenomenon now known as “astroturfing,” American Express and Visa went to great lengths to create the illusion of grassroots support for such laws, even going so far as to create and bankroll a fake consumer group called “Consumers Against Penalty Surcharges.” But real consumer groups—including Consumers Union and Consumer Federation of America—opposed state no-surcharge laws because they discouraged merchants from making the costs of credit transparent, which resulted in an enormous hidden tax paid by all consumers whenever they made a purchase.

48. Texas’s law was enacted in 1985, one year after expiration of the temporary federal ban. TEX. FIN. CODE § 339.001. Although the credit-card industry’s fingerprints are not visible in the law’s legislative history, a mysterious group calling itself the “Association to Ban Surcharges on Credit Cards” hired Bill Clayton, the former Speaker of the Texas House of Representatives, to lobby in support of the law. In addition, the legislative history reveals that the law is indistinguishable from its federal predecessor. The Senate Committee on Economic Development had initially recommended that the law prohibit only “unposted” surcharges, making it significantly narrower than the federal law. But after this version passed the full Senate, the House Committee on Financial Institutions amended the bill to remove the word “unposted” so

that it would apply to *any* surcharge—no matter how prominently disclosed—just as the federal ban had done. After the full House and Senate approved this amended version, it became the law.

49. Shortly thereafter, a New York court concluded that, under that state’s no-surcharge law, “precisely the same conduct by an individual may be treated either as a criminal offense or as lawfully permissible behavior depending only upon the *label* the individual affixes to his economic behavior, without substantive difference.” *People v. Fulvio*, 517 N.Y.S.2d 1008, 1011 (Crim. Ct. N.Y. 1987) (emphasis in original). The court explained: “[W]hat [the law] *permits* is a price differential, in that so long as that differential is characterized as a discount for payment by cash, it is legally permissible; what [the law] *prohibits* is a price differential, in that so long as that differential is characterized as an additional charge for payment by use of a credit card, it is legally impermissible. . . . [The law] creates a distinction without a difference; it is not the *act* which is outlawed, but the *word* given that act.” *Id.* at 1015 (emphasis in original).

50. Around the same time that Texas’s no-surcharge law was enacted, the major credit-card companies changed their contracts with merchants to include no-surcharge rules. No-surcharge laws in Texas and other states thus function as a legislative extension of the restrictions that credit-card issuers previously imposed more overtly by contract. For instance, American Express’s contracts with merchants included an elaborate speech code. The contracts provided that merchants may not “indicate or imply that they prefer, directly or indirectly, any Other Payment Products over our Card”; “try to dissuade Cardmembers from using the Card”; “criticize . . . the Card or any of our services or programs”; or “try to persuade or prompt Cardmembers to use any Other Payment Products or any other method of payment (e.g., payment by check).

The Durbin Amendment and the recent political controversy over swipe fees

51. From the mid-1980s until the 2000s the issue of swipe fees remained largely in the shadows. Even in the majority of states without anti-surcharge laws, the contractual no-surcharge rules ensured that consumers were rarely informed of the true costs of credit. Developments in the late 2000s, however, caused swipe fees to reemerge as a volatile political issue.

52. The global financial crisis of 2007-2008 and the ensuing push for financial-regulation reform resulted in renewed focus on swipe fees. Senator Dick Durbin of Illinois proposed an amendment to the Senate version of the Dodd-Frank Wall Street Reform and Consumer Protection Act that aimed to reduce the fees associated with transactions by both debit and credit cards. Although proposed legislation to regulate *credit-card* swipe fees was defeated, the Durbin Amendment was enacted into law. As enacted, it establishes a procedure by which the Federal Reserve Board now sets the maximum swipe fees for *debit-card* transactions. 15 U.S.C. § 1693o-2(a). It also includes a provision protecting merchants' rights to offer consumers incentives for using different payment methods: "A payment card network shall not ... by contract, requirement, condition, penalty, or otherwise, inhibit the ability of any person to provide a discount or in-kind incentive for payment by the use of cash, checks, debit cards, or credit cards." *Id.* § 1693o-2(b)(2).

53. The fight over the Durbin Amendment shone a spotlight on the amount of revenue that banks generate from swipe fees, initiated a frenzy of lobbying by the credit-card industry, and touched off a contentious national political debate. Many merchants sought to convey their opposition to swipe fees directly to their customers—and voters—at the checkout counter. The national convenience store chain 7-Eleven, for example, put

up signs asking customers to “STOP UNFAIR CREDIT CARD FEES” and gathered a total of 1.6 million signatures on a petition to support legislation on credit-card fees. 7-Eleven claimed that its petition represented the largest quantity of signatures ever presented to Congress—trumping even the 1.3 million signatures presented to Congress regarding national healthcare reform.

**Visa, MasterCard, & American Express
drop their no-surcharge rules**

54. In May 2005, Animal Land Inc., a pet-relocation company based in Atlanta, Georgia, sued Visa for a declaration that its no-surcharge rule violated antitrust laws by preventing Animal Land and other merchants from assessing a discrete, denominated charge upon customers using credit cards, as opposed to cash, checks, or debit cards. *Animal Land, Inc. v. Visa USA, Inc.*, No. 05-CV-1210 (N.D. Ga.). In the ensuing months, numerous U.S. merchants and trade associations brought claims against the dominant credit-card networks, alleging that they engaged in illegal price-fixing and impermissibly banned merchants from encouraging customers to use less expensive payment methods.

55. Under the terms of a national class-action settlement, Visa and MasterCard in January 2013 dropped their prohibitions against merchants imposing surcharges on credit-card transactions. And in December 2013—in response to a separate lawsuit—American Express agreed to drop its surcharge ban as well.

56. As a result, state no-surcharge laws—previously redundant because of contractual no-surcharge rules—have now gained added importance. And as they did in the 1980s, credit-card companies are once again seeking to discourage dual pricing by pushing state legislation that dictates the labels that merchants can use for such systems.

Texas ramps up enforcement of its no-surcharge law

57. In response to the elimination of the contractual no-surcharge rules, Texas expanded enforcement of its no-surcharge law in two significant ways. First, the legislature amended the law to improve enforcement efforts. Prior to 2013, the Texas Finance Commission had exclusive authority to enforce the statute. But that commission is only a governing body that oversees three Texas agencies (including the OCCC); it does not have investigation staff or a legal department of its own to conduct enforcement proceedings. This mistake has now been fixed. The legislature transferred enforcement authority to the OCCC. *See* TEX. FIN. CODE § 339.001. With that delegation, the OCCC is now prepared to enforce the law against merchants across the state who express the costs of credit to their customers in the wrong way.

58. Second, the agency seems to be doing just that. It has contacted dozens of merchants suspected of violating the law and notified them of its prohibition on surcharges. In one instance, the OCCC sent a letter to a merchant after receiving the following complaint: “Marty tells customers if paying with credit card its [sic] 3% more.” The OCCC’s letter demanded that the merchant “[c]ease this practice for all future services as it appears to be in conflict with [the no-surcharge law].” Letter from Mark Baker, OCCC, to Marty Hester (Feb. 22, 2013).

New York’s no-surcharge law is declared unconstitutional

59. In June 2013, five merchants—supported by several national consumer groups and retailers as amici curiae—brought a constitutional challenge to New York’s no-surcharge law in federal district court, claiming that it violated the First Amendment and was unconstitutionally vague. By making liability “turn[] on the language used to describe identical conduct,” they argued, the law is a content-based speech restriction

that is subject to heightened scrutiny, which it cannot withstand. They further argued that the law is unconstitutionally vague because it does not define the line between a “surcharge” and a “discount,” and “[y]et that line marks the difference between what is [illegal] and what is not.”

60. The court agreed. In October 2013, it declared the law unconstitutional and granted a preliminary injunction against its enforcement. *See Expressions*, --- F. Supp. 2d ---, 2013 WL 5477607. One month later, final judgment, including a permanent injunction, was entered in favor of the plaintiffs.

Claims for Relief

Claim One: Violation of the First Amendment (under 42 U.S.C. § 1983)

61. Texas’s no-surcharge law regulates how the plaintiffs may characterize the price differences they may lawfully charge for credit and cash purchases. The law allows them to tell their customers that they are paying *less* for using cash or other means of payment (a “discount”), but not that they are paying *more* for using credit (a “surcharge”). This state-imposed speech code prevents the plaintiffs from effectively conveying to their customers—who absorb the costs of credit through higher prices for goods and services—that credit cards are a more expensive means of payment.

62. By prohibiting certain disfavored speech by merchants, Texas’s no-surcharge law violates the plaintiffs’ First Amendment rights, as applied to the states through the Fourteenth Amendment. Because the no-surcharge law is a content- and speaker-based restriction on speech, it is subject to heightened scrutiny under the First Amendment. *See Sorrell v. IMS Health Inc.*, 131 S. Ct. 2653 (2011). Regardless of whether the law is analyzed under a special commercial-speech inquiry, it cannot survive. The prohibited speech concerns lawful activity (engaging in dual pricing) and is not

misleading; Texas has no substantial interest in prohibiting the speech; and Texas’s no-surcharge law does not directly advance—and is far more extensive than necessary to serve—any interest the state might have. *See Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm’n of New York*, 447 U.S. 557 (1980).

Claim Two: Void for vagueness (under 42 U.S.C. § 1983)

63. Texas’s no-surcharge law does not provide guidance about what speech is permitted and invites arbitrary and discriminatory enforcement. Because the law makes liability turn on the blurry difference between two ways of describing the same conduct, the law does not provide a person of ordinary intelligence reasonable opportunity to know what is prohibited. Additionally, the Texas law lacks explicit standards for those charged with its enforcement. It is therefore unconstitutionally vague under the Due Process Clause of the Fourteenth Amendment.

Request for Relief

For the reasons given above, the plaintiffs request that the Court:

- A. Declare that Texas’s no-surcharge law, TEX. FIN. CODE § 339.001, is unconstitutional and enjoin its enforcement;
- B. Award the plaintiffs their reasonable costs, expenses, and attorney’s fees under 42 U.S.C. § 1988; and
- C. Award the plaintiffs all other appropriate relief.

Date: March 5, 2013

Respectfully submitted,

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