NORTH CAROLINA BANKING INSTITUTE

Volume 22 | Issue 1 Article 18

3-1-2018

Expression Yourself: An Analysis of the Interaction Between the Durbin Amendment and New York Surcharge Ban of the New York General Business Law

Peter J. Cline

Expression Yourself: An Analysis of the Interaction Between the Durbin Amendment and New York Surcharge Ban of the New York General Business Law

I. INTRODUCTION

According to the Southern District of New York, "*Alice in Wonderland* has nothing on Section 518."[1] The law is less grounded in reality than Lewis Carrol's fantasy novel about the dreams of a young Victorian adolescent since it only limits how merchants communicate the price disparity between credit cards and cash users.[2] Section 518 of the New York General Business Law ("New York Surcharge Ban"), prohibits New York merchants from imposing surcharges on credit cards transactions even though the transactions cost the merchant more than cash purchases.[3]

However, the New York Surcharge Ban does not apply to merchants that charge a higher initial price and then provide a discount to cash users.[4] This discount exception means that the statute does not regulate prices, but rather how the prices are communicated.[5] New York merchants are given a Sophie's choice to either inexplicitly charge higher prices, coupled with an equally unexplainable cash discount, or risk violating state law by allocating higher credit cards costs directly to credit

1. Expressions Hair Design v. Schneiderman, 975 F. Supp. 2d 430, 435 (S.D.N.Y. 2013).

2. *See id*. (comparing *Alice in Wonderland* with the New York statute).

3. N.Y. GEN. BUS. LAW § 518 (McKinney 1984) ("No seller in any sales transaction [in New York] may impose a surcharge on a holder who elects to use a credit card in lieu of payment by cash, check, or similar means."); Justin Pritchard, *Why the Choice Between Debit or Credit Matters*, THE BALANCE (updated Apr. 24, 2017), https://www.thebalance.com/debit-or-credit-315293.

4. Noah Feldman, *Cash Discounts, Credit Surcharges and Free Speech*, BLOOMBERG (Jan. 10, 2017, 2:10 PM), https://www.bloomberg.com/view/articles/2017-01-10/cash-discounts-credit-surcharges-and-free-speech.

5. Expressions Hair Design v. Schneiderman, 137 S. Ct. 1144, 1148 (2017).

card users.[6] As a result, the New York Surcharge Ban regulates merchant speech.[7]

The Durbin Amendment—a component of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank")—limits the amount of interchange fees that banks can charge for debit card transactions.[8] Banks charge merchants interchange fees for the ability to accept credit and debit cards in their stores.[9] Since the Durbin Amendment caps only debit card interchange fees, credit card companies are incentivized to encourage credit card use among their customers.[10] Yet, merchants pay higher interchange fees on credit cards than debit cards.[11] Although merchants are incentivized to pass both card processing fees to consumers, they are especially incentivized to transfer the credit card interchange fees.[12] Unfortunately, the New York Surcharge Ban infringes on the merchant's ability to take this business

6. *See* Feldman, *supra* note 4 ("[M]erchants are barred from charging credit-card purchasers a surcharge, but are allowed to offer discounts for paying in cash."). Sophie's choice refers "to a difficult situation in which a person must choose between two equally deserving alternatives." *Sophie's choice*, OXFORD LIVING DICTIONARIES, https://en.oxforddictionaries.com/definition/sophie%27s_choice (last visited Jan. 29, 2018).

7. Feldman, supra note 4.

8. 15 U.S.C. § 1693o-2(a) (2012); 12 C.F.R. § 235.5(a) (2012). The Durbin Amendment regulates the amount that banks with $10 billion or more in assets can charge for debit card interchange fees. 15 U.S.C. § 1693o-2(a)(6). The Amendment is part of Dodd–Frank, which was passed following the Financial Crisis of 2008. *Id.*; Dodd-Frank Wall Street Reform and Protection Act ("Dodd-Frank") § 1021, 12 U.S.C § 5511. Dodd-Frank requires banks to increase their reserves as well as hold a larger percentage of their portfolio in "easily liquidated" assets. John Mazfield, *The Dodd-Frank Act Explained*, USA TODAY (updated Feb. 3, 2017, 6:46 PM), https://www.usatoday.com/story/money/2017/02/03/the-doddfrank-act-explained/97454748/.

9. *Understanding Interchange*, MASTERCARD, https://www.mastercard.us/en-us/about-mastercard/what-we-do/interchange.html (last visited Jan. 14, 2018).

10. Scott D. Strockoz, Dodd-Frank and the Durbin Amendment—Is it Working as Intended?, CAPSTONE STRATEGIC PROJECT FOR THE AM. BANKERS ASS'N STONIER GRADUATE SCH. OF BANKING 13–14 (2012), http://www.abastonier.com/stonier/wp-content/uploads/2012-Capstone-Strokoz.pdf; *see also* Todd Zywicki et al., *Price Controls on Payment Card Interchange Fees: The U.S. Experience* 19 (Geo. Mason U. Law & Econ. Research Papers Series, Working Paper No. 14–18, June 2014), https://www.law.gmu.edu/assets/files/publications/working_papers/1418.pdf (explaining how banks intensely pushed for debit card holders to begin using credit cards) (internal quotations omitted).

11. Pritchard, *supra* note 3.

12. *See* Pritchard, *supra* note 3 ("Retailers . . . . prefer that you choose debit so that they don't have to pay a hefty interchange fee.").

savvy action.[13] However, the constitutionality of New York's Surcharge Ban is in question.[14]

On March 29, 2017, the Supreme Court of the United States ruled that although the New York Surcharge Ban "regulates speech," the issue of whether it "survive[s] First Amendment scrutiny" will have to be decided by the Second Circuit.[15] A ruling against New York's Surcharge Ban would protect the First Amendment rights of merchants, as well as their ability to conduct efficient business.[16]

This Note analyzes the tension caused by the coexistence of the Durbin Amendment and the New York Surcharge Ban. It proceeds in five parts. Part II provides background knowledge regarding interchange fees, the New York Surcharge Ban, and the Durbin Amendment.[17] Part III analyzes *Expressions Hair Design v. Schneiderman*, the recently remanded Supreme Court case, and the relevant First Amendment implications of the New York Surcharge Ban.[18] Part IV outlines the negative effects that the Durbin Amendment and the New York Surcharge Ban have on New York merchants.[19] Part V summarizes the previous arguments and suggests a further course of action.[20]

II. THE BASICS OF A CREDIT/DEBIT CARD TRANSACTION

A. Credit Card Transactions

In many credit card transactions, there are four parties to consider: the consumer, the merchant, the acquiring bank, and the issuing

---

13. *See* Expressions Hair Design v. Schneiderman, 137 S. Ct. 1144, 1155 (2017) (Sotomayor, J., concurring) ("[Plaintiffs] do not use their preferred pricing systems or displays for fear of violating § 518.").

14. *Id*. at 1147 (majority opinion).

15. *Id*. at 1151. The Supreme Court ruled only on whether the state law regulates free speech. *Id* at 1145. The Court then remanded the case to the Second Circuit to decide if the regulation of speech "survive[s] First Amendment scrutiny." *Id*.

16. *See* Feldman, *supra* note 4 ("The issue in the case . . . . [is] how merchants are allowed to describe the prices that exist as a matter of economic reality. That should subject the rule to at least the level of free-speech analysis that applies to commercial transaction . . . .").

17. *See infra* Part II.

18. *See infra* Part III.

19. *See infra* Part IV.

20. *See infra* Part V.

bank.[21] Credit card companies, through issuing banks, provide credit and debit cards to consumers.[22] Acquiring banks contract with merchants that choose to accept credit card transactions.[23]

In a typical card transaction there is a four-part sequence among these parties.[24] First, a consumer uses a credit or debit card to make a purchase from a merchant.[25] Second, the merchant contacts an acquiring bank, which transfers the requested funds to the merchant.[26] The acquiring bank deducts a small percentage of the merchant payment, called a "discount fee," for processing the debit or credit card payments.[27] Third, the issuing bank will reimburse the acquiring bank less an "interchange fee."[28] The acquiring bank will pass along this fee to merchants by charging a discount fee that is at least equal to the interchange fee.[29] Finally, the issuing bank withdraws funds, equal to the total purchase price, from the cardholder's account.[30]

Interchange fees compensate issuing banks for the lost interest incurred during the "cardholder's grace period for repaying their debt."[31] The cost of interchange fees is "based on authorization costs, losses due to fraud and credit and the average bank cost of the funds."[32] Intuitively, the fees should be as low as possible, since there are a number of competing credit card companies.[33] However, because the issuing banks

21. Richard Gendal Brown, *A Simple Explanation of Fees in the Payment Card Industry*, RICHARD GENDAL BROWN (Aug. 9, 2014, 6:47 PM), https://gendal.me/2014/08/09/a-simple-explanation-of-fees-in-the-payment-card-industry/.

22. *In re* Visa Check/Mastermoney Antitrust Litigation, 280 F.3d 124, 130 (2d Cir. 2002).

23. *Id*.

24. *Id*.

25. Brown, *supra* note 21.

26. Brown, *supra* note 21.

27. Brown, *supra* note 21.

28. *In re* Visa Check/Mastermoney Antitrust Litigation, 280 F.3d 124, 130 (2d Cir. 2002).

29. *Id*.

30. *Id*.

31. Ben Dwyer, *Interchange Rates and Fees*, CARDFELLOW, https://www.cardfellow.com/interchange-fee/ (last visited Jan. 14, 2018).

32. *Interchange Rate*, INVESTOPEDIA, http://www.investopedia.com/terms/i/interchange-rate.asp (last visited Jan. 14, 2018).

33. *See* European Commission Press Release MEMO/16/2162, Antitrust: Regulation of Interchange Fees (June 9, 2016), http://europa.eu/rapid/press-release_MEMO-16-2162_en.htm ("Usually, competition leads to lower prices since companies compete by offering lower prices than their competitors. In the case of interchange fees, the opposite occurs.").

benefit from the interchange fees, credit card companies must compete for the issuing banks' business by offering "*higher* interchange fees."[34] Consequently, merchants are charged a higher discount fee since the discount fee is heavily contingent on the price of interchange fees.[35]

B. *Debit Card Transactions*

Debit card purchases are comprised of on-line or off-line transactions.[36] During an on-line transaction, a debit card user enters their "personal identification number" ("PIN") into a store-owned PIN pad.[37] The issuing bank then immediately confirms that the cardholder has sufficient funds before transferring it to the acquiring bank.[38] Therefore, issuing banks have less risk of receiving a default payment from the consumer.[39]

During an off-line purchase, debit card holders do not enter a PIN, but instead sign a slip to authorize the transaction.[40] Issuing banks do not always verify that the debit card user has sufficient funds.[41] As a result, issuing banks have similar levels of consumer default risk for both credit card purchases and off-line debit card purchases.[42] However, even with the disparity in risk between on-line and off-line purchases, both payment systems have similar average interchange fees.[43] Specifically, on-line purchases charge $0.23 per transaction, while off-line purchases charge $0.24 per transaction.[44]

34. *Id*.
35. *In re* Visa Check/Mastermoney Antitrust Litigation, 280 F.3d at 130.
36. *Id*.
37. *Id*.
38. *Id*. at 130–31.
39. *Id*. at 131.
40. *Id*.
41. *Id*.
42. *See id*. ("[T]he card-issuing institutions does not necessarily verify that there are sufficient funds . . . .").
43. BD. OF GOVERNORS OF THE FED. RES. SYS., REGULATION II (DEBIT CARD INTERCHANGE FEES AND ROUTING), https://www.federalreserve.gov/paymentsystems/regii-average-interchange-fee.htm (last updated July 14, 2017).
44. *Id*.

C. Durbin Amendment

Free-market enthusiasts heavily criticized the passage of the Durbin Amendment for disrupting the interactions between customers, merchants, and prepayment cards.[45] But politicians justified the legislation with the promise that acquiring banks would pass along their savings—from lower interchange fees—to merchants who would then charge consumers less for goods.[46] In addition, the Durbin Amendment allowed small banks, with less than $10 billion in assets, to continue charging their usual debit card rates.[47] Unfortunately, any benefits these small banks received was undermined by the compliance costs associated with other portions of Dodd-Frank.[48]

Under the Durbin Amendment, issuing banks can only charge amounts that are "reasonable and proportional" to their incurred costs in debit card transactions.[49] These restrictions limit interchange fees to the combination of $0.21 plus five basis points for each transaction.[50] Although lower debit card interchange fees typically benefit consumers,[51] the Durbin Amendment also forbids the reimbursement of many expenses related to debit card interchange fees including "customer service, data services, branch networks, card issuance, [as well as] fraud and loss protection."[52] These changes, which went into effect on October 11,

45. *See* Rob Nichols, *The Durbin Amendment: A Costly Price Control Experiment*, THE HILL (June 27, 2016, 9:46 AM), http://thehill.com/blogs/congress-blog/economy-budget/284842-the-durbin-amendment-a-costly-price-control-experiment ("Price controls have faded away for a reason, and the Durbin Amendment is one more example of an idea whose time has gone.").

46. *Id*.

47. 12 C.F.R. § 235.5(a)(1)(ii).

48. *See* Nichols, *supra* note 45 ("[C]ommunity banks, even those that were supposedly 'exempted' from the Durbin Amendment, have faced increased compliance costs related to the law's other provisions.").

49. 12 C.F.R. § 235.3(a).

50. *Id*. In 2015, the average interchange fee fell to $0.23. BD. OF GOVERNORS OF THE FED. RES. SYS., 2015 INTERCHANGE FEE REVENUE, COVERED ISSUER COSTS, AND COVERED ISSUER AND MERCHANT FRAUD LOSSES RELATED TO DEBIT CARD TRANSACTIONS 3, https://www.federalreserve.gov/paymentsystems/files/debitfees_costs_2015.pdf.

51. Margarette Burnette, *The Durbin Amendment Explained*, NERDWALLET, https://www.nerdwallet.com/blog/banking/durbin-amendment-explained/ (last updated Aug. 30, 2017).

52. Zywicki et al., *supra* note 10, at 5.

2011,[53] are estimated to cost banks between \$6.6 and \$8 billion in annual revenue.[54]

In order to recoup the lost revenue, banks encourage credit card use—as opposed to debit card use—among their customers since credit card usage results in a higher fee on each transaction.[55] For example, MasterCard's "Standard" fee on "Core Value" credit card transactions is 2.95% of the amount purchased, in addition to a \$0.10 fixed fee, while debit card transaction fees are limited to \$0.21 plus five basis points of each transaction's value.[56] Specific techniques used by banks to increase credit card use include reducing debit card reward programs and offering free checking accounts.[57] Banks also attracted more credit card users by increasing their direct-mail sales efforts.[58] These efforts were successful, and debit card growth has declined since the Durbin Amendment's passage.[59] In 2009, debit cards accounted for 35% of retail payments.[60] However, by 2011, debit card usage plummeted to 23.7%, while credit card purchases increased by 27.8%.[61]

Some of the measures taken by banks to increase credit card usage have come at the expense of low-income individuals.[62] Merchants raise their prices in order to pass along the credit card surcharge to their customers.[63] This produces an inequitable result since both cash payers and credit users pay for the price increases, but many low-income earners are not responsible for the credit card surcharge.[64] This is because many

53. Zywicki et al., *supra* note 10, at 5.

54. Zywicki et al., *supra* note 10, at 5.

55. Zywicki et al., *supra* note 10, at 18 (citing Todd Zywicki, *The Dick Durbin Bank Fees*, WALL ST. J. (Sept. 29, 2011, 7:07 PM), https://www.wsj.com/articles/SB10001424052970204831304576597173130633798.

56. 12 CFR § 235.3; *Mastercard 2017–2018 U.S Region Interchange Programs and Rates*, MASTERCARD (Jan. 19, 2017), https://www.mastercard.us/content/dam/mccom/en . . ./merchant-interchange-rates.pdf.

57. Burnette, *supra* note 51.

58. Zywicki, *The Dick Durbin Bank Fees*, WALL ST. J. (Sept. 29, 2011, 7:07 PM), https://www.wsj.com/articles/SB10001424052970204831304576597173130633798.

59. Zywicki et al., *supra* note 10, at 18.

60. Fumiko Hayashi, *The New Debit Card Regulations: Initial Effects on Networks and Banks*, FED. RES. BANK OF KAN. CITY ECON. REV. 82 (2012), http://www.kansascityfed.org/publicat/econrev/pdf/12q4Hayashi.pdf.

61. Strockoz, supra note 10, at 14.

62. *See* Brief for Petitioner at 6, Expressions Hair Design v. Schneiderman, 975 F. Supp. 2d 430 (S.D.N.Y. 2013) (No. 13-4533) ("This state of affairs results in high-cost, high-reward credit card users being subsidized by low-cost credit card users . . . .").

63. Brief for Petitioner, *supra* note 62, at 5.

64. Brief for Petitioner, *supra* note 62, at 6.

low-income individuals do not own a credit card.[65] Hence, these surcharges have caused poor people to help pay for the credit card usage of "wealthy Platinum card holder[s]."[66]

D. State Surcharge Bans

In 1974, Congress amended the Truth in Lending Act ("TILA") to forbid credit and debit card issuers from stopping merchants from issuing discounts to cash paying customers.[67] TILA was amended again, in 1976, to bar businesses from implementing surcharges on credit card using customers.[68] The surcharge ban did not last long.[69] Although the TILA surcharge ban expired in 1984, the prohibition on "contractually barr[ed] discounts" for cash paying customers stayed in force.[70] Eleven states passed surcharge bans in response to the lack of federal legislation.[71] Ultimately, *Expressions* will decide whether state surcharge bans can continue to infringe on the First Amendment.[72]

III. MERCHANTS' FIRST AMENDMENT CHALLENGE TO NEW YORK'S SURCHARGE BAN

Similar to surcharge bans passed in other states, the New York Surcharge Ban prohibits merchants from charging credit card users a higher amount than cash users.[73] However, this ban does not apply to

65. Brief for Petitioner, *supra* note 62, at 6.

66. Brief for Petitioner, *supra* note 62, at 5.

67. Expressions Hair Design v. Schneiderman, 137 S. Ct. 1144, 1147 (2017) (citing amendments adopted in 1974 to the TILA, which can be found in Pub.L. 93-495, § 306, 88 Stat. 1515).

68. *Id*. (citing amendments to the TILA adopted on February 27, 1976, which can be found in Pub.L. 94-222, § 3(c)(1), 90 Stat. 197).

69. *Id*.

70. *Id*.

71. California, Colorado, Connecticut, Florida, Kansas, Maine, Massachusetts, New York, Oklahoma and Puerto Rico have imposed bans on credit card surcharges. Heather Morton, *Credit Card or Debit Card Surcharge Statutes*, NAT'L CONF. OF ST. LEGISLATURES (Oct. 13, 2016), http://www.ncsl.org/research/financial-services-and-commerce/credit-or-debit-card-surcharges-statutes.aspx. California's surcharge law—similar to New York's—forbid merchants from implementing a surcharge on payments made with a credit card. *Id*. A federal district court later found California's surcharge law to be in violation of the First Amendment. *Id*.

72. *Expressions*, 137 S. Ct. at 1144.

73. N.Y. GEN. BUS. LAW § 518 (McKinney 1984) ("No seller in any sales transaction [in New York] may impose a surcharge on a holder who elects to use a credit card in lieu of

merchants that charge a higher initial price and then provide a discount to cash purchasers.[74] As explained by the Second Circuit, "if a seller's regular price is $100, it may not charge credit-card customers $103 and cash customers $100, but if the seller's regular price is $103, it *may* charge credit card customers $103 and cash customers $100."[75] The merchants did not use this method because they wanted their consumers to know "that they are not the bad guys," and that customer hostility should instead be directed at credit card companies.[76] This exception causes the statute to regulate speech since merchants are unable to publicize to customers that the reason for the increased prices is because of credit card surcharges.[77]

Numerous merchants challenged the legality of the New York Surcharge Ban on credit card transactions in the case of *Expressions Hair Design v. Schneiderman*.[78] In *Expressions*, the plaintiffs—five New York merchants—attempted to pass along surcharges to their customers who chose to use credit cards instead of cash.[79] The merchants alleged that a significant portion of their revenue is spent on credit card discount fees to acquiring banks.[80]

The Supreme Court ruled that the New York Surcharge Ban does regulate merchant speech and subsequently remanded *Expressions* to the Second Circuit to decide if the statute's regulation of speech is unconstitutional.[81] Ultimately, the Second Circuit will decide if the statute is constitutional under the commercial speech standard established in *Central Hudson Gas*.[82]

payment by cash, check, or similar means."); *see also* Pritchard, *supra* note 3 (Merchants prefer to "add credit card surcharges (which aren't allowed with debit card purchases under federal law) . . . to customers that pay with plastic.").

74. Feldman, *supra* note 4.

75. Expressions Hair Design v. Schneiderman, 808 F.3d 118, 128 (2d Cir. 2015), *vacated and remanded*, 137 S. Ct. 1144 (2017).

76. Expressions, 137 S. Ct. at 1148.

77. *Id*.

78. *Id*. at 1155.

79. *Id*.

80. *Id*. The Truth in Lending Act ("TILA") defines surcharges as "any means of increasing the regular price to a cardholder which is not imposed upon customers paying by cash, check, or similar means." 15 U.S.C. § 1602(r) (2016).

81. *Expressions*, 137 S. Ct. at 1151.

82. *Id*. Essentially when it comes to commercial speech, the Supreme Court uses intermediate scrutiny. Erwin Chemerinsky, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 1090 (3d ed. 2006) (citing *Florida Bar v. Went for It, Inc.*, 515 U.S. 618, 623 (1995)).

Under the *Central Hudson Gas* standard, the State of New York will have to satisfy a four-part test in order for its statute to be found constitutional.[83] First, the commercial speech "must concern lawful activity and not be misleading."[84] Second, the government's interest in advancing the statute must be substantial.[85] Third, the legislation must "directly advance the government's interest."[86] Fourth, the legislation must not be "more extensive than necessary to achieve the government's interest."[87]

During the case, New York attempted to satisfy the test by providing two justifications.[88] Specifically, the State claims that the law will prevent "bait and switch tactics" as well as limit the ability of merchants to charge unnecessarily high fees.[89] However, neither of the two justifications meet the necessary threshold outlined in *Central Hudson Gas*.[90]

Eric Schneiderman, the New York Attorney General, alleges that there are two justifications for enforcing the New York Surcharge Ban.[91] Schneiderman first claims that the New York Surcharge Ban prevents the use of "bait and switch tactics."[92] These tactics refer to merchants who advertise one price on the shelf and then charge a different price at the register.[93] Schneiderman then claims that the legislation stops merchants from "us[ing] surcharges to 'levy excessive fees on customers.'"[94] These justifications are either overbroad or too invasive.[95] Therefore, the New York Surcharge Ban should fail under the fourth *Central Gas* prong since

83. CHEMERINSKY, *supra* note 82, at 1090 (citing Central Hudson Gas v. Public Service Commission, 447 U.S. 557, 566 (1980)).

84. CHEMERINSKY, *supra* note 82, at 1090 (citing *Central Hudson Gas*, 447 U.S. at 566).

85. CHEMERINSKY, *supra* note 82, at 1090.

86. CHEMERINSKY, *supra* note 82, at 1090.

87. CHEMERINSKY, *supra* note 82, at 1090.

88. Brief for Petitioner at 10–11, Expressions Hair Decision v. Schneiderman, No. 13-4533 (2d Cir. June 20, 2017).

89. *Id*. (citing Appellant Schneiderman Suppl. Letter Br. at 25–26, filed July 13, 2017, Dkt. No. 259).

90. *Id*. at 11.

91. *Id*. at 10–11.

92. *Id*. at 11 (citing Appellant Schneiderman Suppl. Letter Br. at 25–26, filed July 13, 2017, Dkt. No. 259).

93. *Id*.

94. *Id*. (citing Appellant Schneiderman Suppl. Letter Br. at 26–30, filed July 13, 2017, Dkt. No. 259).

95. *Id*. at 11–12 (explaining that New York's justifications for the surcharge ban either "hugely overbroad" or can be accomplished through "less restrictive means.").

the state legislation is "more extensive than necessary to serve the State's interest."[96]

Although the New York Surcharge Ban may undermine "bait and switch tactics," it is "hugely overbroad."[97] Instead, the state legislature should implement disclosure rules, which forbid merchants from publicizing one price and then charging a different price.[98] This method protects consumers from excessive surcharging without being unnecessarily broad.[99] These rules suggest that surcharges and discounts should be disclosed and made available to customers.[100]

New York's second justification can also be met with a less intrusive method.[101] Although the surcharge ban is one method to dissuade "excessive fees," the State's objectives can be achieved through more specific means.[102] For example, Minnesota law forbids surcharges from "exceed[ing] [5%] of the purchase price."[103] New York could also enforce its current false-advertising laws.[104] The New York Surcharge Ban operates as an "*anti-disclosure* law" by inhibiting communication between merchants and consumers as to the impact that credit cards have on store prices.[105] In addition, the State's concern for "excessive fees" is misguided since there is little evidence to support its existence.[106] In fact, the State's cited study "concedes" that there is limited empirical evidence to suggest that merchants are charging excessive fees.[107] The study even

96. CHEMERINSKY, *supra* note 82, at 1090 (citing Central Hudson Gas v. Public Service Commission, 447 U.S. 557, 566 (1980)).

97. Brief for Petitioner, *supra* note 62, at 11.

98. Brief for Petitioner, *supra* note 62, at 11–12.

99. Brief for Petitioner, *supra* note 62, at 11–12 (citing *Cash Discount Act, 1981*: *Hearing on S. 414 Before the Senate Banking Comm.*, 97th Cong., 1st Sess. 10 (Feb. 18, 1981)).

100. *See* Brief for Petitioner, *supra* note 62, at 12 ("Disclosure requirements like those proposed by the Federal Reserve Board would entirely protect consumers from abusive surcharging.").

101. Brief for Petitioner, *supra* note 62, at 12.

102. Brief for Petitioner, *supra* note 62, at 13.

103. Brief for Petitioner, *supra* note 62, at 13 (citing MINN. STAT. ANN. § 325G.051(1)(a) (West 2004)).

104. Brief for Petitioner, *supra* note 62, at 13.

105. Brief for Petitioner, *supra* note 62 (explaining that New York's no-surcharge law acts as an anti-disclosure law by forcing merchants to "keep consumers in the dark about the true cost of credit card usage").

106. Brief for Petitioner, *supra* note 62, at 12.

107. Brief for Petitioner, *supra* note 62 (citing Marc Rysman & Julian Wright, The Economics of Payment Cards, at 16 (Nov. 29, 2012) (Working Paper, Boston University & National University of Singapore)).

recognizes that additional research on "surcharg[e] behavior" would be helpful.[108]

IV. DETRIMENTAL EFFECTS

The Durbin Amendment and the New York Surcharge Ban have led to many negative consequences for merchants and consumers.[109] One example is that small merchants do not receive the same favorable terms as large retailers since small merchants are not responsible for a sufficient number of transactions.[110] In addition, the Durbin Amendment saves small merchants less than as was originally expected because credit card companies have started to charge small merchants more for credit card transactions in order to recoup the lost revenue from capped debit card interchange fees.[111] Therefore, New York merchants must pay the heightened transaction fees with less than expected savings.[112] Also, low-income consumers will be forced to pay a portion of credit costs even though they often do not utilize a credit card.[113] This is because New York merchants are unable to directly charge credit card users through surcharges.[114]

108. Brief for Petitioner, *supra* note 62 (citing Marc Rysman & Julian Wright, The Economics of Payment Cards, at 16 (Nov. 29, 2012) (Working Paper, Boston Univserity & National University of Singapore)).

109. Brief for Petitioner, *supra* note 62, at 9–10.

110. Samuel Merchant, *Merchant Restraints: Credit-Card-Transaction Surcharging and Interchange-Fee Regulation in the Wake of Landmark Industry Changes*, 68 OKL. L. REV. 327, 339 (2016).

111. IAN LEE ET AL., CREDIT WHERE IT'S DUE: HOW PAYMENT CARDS BENEFIT CANADIAN MERCHANTS AND CONSUMERS, AND HOW REGULATION CAN HARM THEM 28 (Oct. 2013).

112. *See also id*. at 33 ("[M]any small merchants have actually seen their interchange fees rise as a result of the Durbin Amendment . . . .").

113. *See* Brief for Petitioner, *supra* note 62, at 6 ("[O]nly about 40[%] of the lowest-income quintile of Americans owns a credit card versus 97[%] of households earning over $120,000 per year.").

114. Brief for Petitioner, *supra* note 62, at 7 ("If New York's no-surcharge law is deemed unconstitutional, consumers will eventually reap the rewards of lower merchant fees . . . ."). Australia passed legislation, similar to the Durbin Amendment, and struggled with the unintended consequences. Howard Chang et al., *The Effect of Regulatory Intervention in Two-Sided Markets: An Assessment of Interchange-Fee Capping in Australia*, REVIEW OF NETWORK ECON. 2 (Sept. 26, 2005), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=820044. Specifically, the country's credit card companies regained their lost revenue through annual and issuing fees, which hurt consumers. *See* EUROPE ECON. CHANCERY HOUSE, THE ECONOMIC IMPACT OF INTERCHANGE FEE REGULATION 38 (Sept. 25, 2014) ("[B]anks responded to the reduction in their revenue from [interchange fees] by increasing the level of other fees."). In addition, a Cannex study suggested that less than 5% of Australian merchants passed along the savings from interchange fees onto consumers.

A. *Small Merchants Have Less Bargaining Power than Large Retailers*

Credit card companies, like Visa and MasterCard, dictate the rules of their respective networks.[115] These rules include the amount of interchange fees that issuing banks may charge acquiring banks.[116] The interchange fee, charged to acquiring banks, inherently determines how much the acquiring bank charges the merchant through discount fees.[117] Ultimately the heightened discount fee affects consumers who have to pay an inflated price.[118]

Regrettably, acquiring banks do not have the power to negotiate for lower credit card interchange fees.[119] In fact, acquiring banks do not even negotiate with individual issuers.[120] Instead, the acquiring banks join a network and implicitly agree to all network rules, including the rate of interchange fees.[121] Therefore, acquiring banks are subject to charge a discount fee that is at least as much as the interchange fee that they are mandated to pay through the network.[122] The insulation of acquiring banks from negotiating interchange fees inherently stops merchants from negotiating their own merchant discount fee.[123]

Large retailers are able to avoid paying these additional transaction fees.[124] The retail conglomerates have higher sales volume, which means that they are responsible for a greater amount of interchange and merchant discount fees charged by the respective banks.[125] Higher sales gives the large retailers leverage over the credit card network, which can be used to force banks to charge a lower merchant discount fee.[126]

Chang et al., *supra* note 114, at 19 (citing Cannex Australia (2004) data on merchant service fees).

115. Merchant, *supra* note 110, at 339.
116. Merchant, *supra* note 110, at 339.
117. *In re* Visa Check/Matermoney Antitrust Litigation, 280 F.3d 124, 130 (2d Cir. 2002).
118. Pritchard, *supra* note 3.
119. Merchant, *supra* note 110, at 339.
120. Merchant, *supra* note 110, at 339.
121. Merchant, *supra* note 110, at 339.
122. Merchant, *supra* note 110, at 339.
123. Merchant, *supra* note 110, at 339.
124. Merchant, *supra* note 110, at 340.
125. Merchant, *supra* note 110, at 340.
126. Merchant, *supra* note 110, at 340.

Unlike large conglomerates, small merchants struggle to assert any leverage over the credit card networks.[127] Therefore, small merchants should be allowed to pass along interchange fees to consumers since they are not in a position to negotiate with the larger credit card corporations.[128] In order to rectify this disparity, New York could allow only small retailers to pass along the fees to their customers.[129] The State could do this by only allowing retailers to charge the higher prices if they are below a certain sales threshold.[130] If New York merchants are not given this option—through an invalidation of Section 518—then they will not be given an opportunity to protect their profit margin.[131]

B. New York Merchants Are Not Saving as Much on the Durbin Amendment as Expected

New York merchants are not saving a tremendous amount of money from the Durbin Amendment.[132] In fact, a survey by the Electronic Payments Coalition revealed that the Durbin Amendment only saved American merchants an average of $0.07 on a $40 debit card transaction.[133] In addition, credit card companies now charge smaller merchants heightened fees.[134] Before the Durbin Amendment, many merchant discount rates were based on a variable percentage of each transaction value.[135] Therefore, a small business, with low-priced goods, would pay lower merchant discount fees than businesses that sold high-

127. Merchant, *supra* note 110, at 339–340.

128. *See* Merchant, *supra* note 110, at 339 ("Thus, the small business owner has no bargaining power to negotiate policies or fees . . . .").

129. *See* Floyd Norris, *Credit Card Subsidies*, N.Y. TIMES (Oct. 2, 2009, 9:36 AM), https://economix.blogs.nytimes.com/2009/10/02/credit-card-subsidies/ ("[B]rings to light many of the things that small retailers have been saying for years. These hidden costs are reluctantly, but necessarily passed on to all consumers . . . .").

130. *See id.* (describing the costs that are incurred by small retailers).

131. *See* Brief for Petitioner, *supra* note 62, at 7 ("[T]he no-surcharge law will continue to continue to facilitate supra-competitive merchant fees, as well as the heightened retail prices and unjust cross-subsidization that such restrictions engender.").

132. *See* LEE ET AL., *supra* note 111, at 33 ("[M]any small merchants have actually seen their interchange fees rise as a result of the Durbin Amendment . . . .").

133. LEE ET AL., *supra* note 111, at 16.

134. *See* LEE ET AL., *supra* note 111, at 17 ("Prior to the Durbin Amendment, [smaller companies] . . . paid a special interchange fee that was lower than for other industries. In response to the Durbin Amendment, however, payment card networks eliminated this subsidized rate . . . .").

135. Burnette, *supra* note 51.

priced goods.[136] After the Durbin Amendment, credit card companies were unable to receive the same level of revenue from the higher priced transactions since they were capped by the $0.21 maximum.[137] Consequently, credit card companies, in an effort to regain lost revenue, started to charge $0.21 on every transaction.[138]

Some large corporations are able to pass the heightened credit card fees to their customers.[139] For example, Redbox increased "its prices for a rental from $1.00 to $1.20 in response to the higher fees imposed . . . ."[140] Although New York merchants can employ the same flat price increase, they are not allowed to indicate to their customers that the reason for the price increase is because of the surcharge restrictions.[141] Unfortunately, New York merchants, because of the New York Surcharge Ban, are unable to indicate the motivations of their practice.[142] Hence, New York merchants are at an immediate disadvantage when trying to recoup the diminished profit margin that results from the Durbin Amendment.[143]

C. *Credit Card Fees are Passed on to the Poor*

The New York Surcharge Ban forces merchants to allocate heightened credit card fees to low-income consumers.[144] These low-income Americans often do not own credit cards and are thus not responsible for the merchant discount fees paid by businesses.[145] In fact,

136. Burnette, *supra* note 51.

137. *See* Burnette, *supra* note 51 ("But when the rules took effect in 2011, big banks began looking for ways to recoup some of the lost revenue, which was estimated at $14 billion a year . . . .").

138. Burnette, *supra* note 51.

139. LEE ET AL., *supra* note 111, at 17.

140. LEE ET AL., *supra* note 111, at 17.

141. *See* Expressions Hair Decision v. Schneiderman, 137 S.Ct. 1144, 1151 (2017) ("The law tells merchants nothing about the amount they are allowed to collect from a cash or credit card payer.").

142. *Id*. at 1148.

143. *See* LEE ET AL., *surpa* note 111, at 17 ("[The Durbin Amendment] has been a debacle for smaller merchants that have actually seen their interchange fees *rise* . . . .").

144. *See* Brief for Petitioner, *supra* note 62, at 6 ("[H]igh-cost, high-reward credit card users [are] being subsidized by low-cost credit card users and, to a greater extent, debit card and cash-based consumers.").

145. *See* Brief for Petitioner, *supra* note 62 (describing that many low-income consumers do not own credit cards, which consequently means that they are not responsible for the additional card fees incurred by merchants).

approximately 97% of Americans earning over a $120,000, own a credit card, while "only about 40[%] of the lowest-income quintile of Americans own a credit card."[146] Therefore, merchants have attempted to avoid allocating costs to low-income consumers by charging credit card users directly via surcharges.[147]

Merchants in thirty-nine states are able to impose surcharges onto credit card users, which allows them to avoid allocating costs to low-income consumers.[148] Merchants will even advertise these surcharges by using signs similar to the one described by the Supreme Court—"$10 (we add a 3% surcharge if you pay by credit card)."[149] However, the New York Surcharge Ban forbids merchants from imposing any surcharge onto customers using credit cards.[150] As a result, merchants must disperse the added costs onto all consumers, including low-income customers.[151] Added costs lead to higher prices, which disproportionately affects low-income customers.[152]

V. CONCLUSION

The Durbin Amendment capped the amount that banks can charge on debit card interchange fees.[153] The Amendment's passage inadvertently incentivized credit card companies to encourage the use of credit cards, rather than debit cards, since credit cards continue to have unregulated interchange fees.[154] Credit card companies have been successful in promoting credit card use even though their interchange fees are higher than debit card interchange fees.[155]

146. *See* Brief for Petitioner, *supra* note 62 (citing Scott Schuh et al., Federal Reserve Bank of Boston, *Who Gains and Who Loses from Credit Card Payments?*, at 3 (2010), https://www.bostonfed.org/economic/ppdp/2010/ppdp1003.pdf.

147. *See* Norris, *supra* note 129 ("The most effective and fair solution is to charge the additional costs of transactions using credit cards to the consumers who choose to use them.").

148. Morton, *supra* note 71.

149. Expressions Hair Decision v. Schneiderman, 137 S. Ct. 1144, 1149 (2017).

150. N.Y. GEN. BUS. LAW § 518 (McKinney 2010).

151. Brief for Petitioner, *supra* note 62, at 6.

152. Brief for Petitioner, *supra* note 62, at 6 ("[I]n absolute terms, the estimated transfer is about $1.4 billion to $1.9 billion from poorer, non-rewards card users to wealthier, rewards card users on gasoline and grocery purchases alone.").

153. 12 C.F.R. § 235.5(a) (2017).

154. Zywicki et al., *supra* note 10, at 17–18 (citing Todd Zywicki, *The Dick Durbin Bank Fees*, WALL ST. J. (Sept. 29, 2011, 7:07 PM), https://www.wsj.com/articles/SB10001424052970204831304576597173130633798; *see* 15 U.S.C. § 1693o-2(a)(2) (2016).

155. Zywicki et al., *supra* note 10, at 20.

Despite the increase in credit card usage, with high interchange fees, New York merchants are forbidden from publicizing that they are charging a higher amount on goods because of the interchange fees on credit cards.[156] The legislation also hurts low-income consumers because merchants are unable to pass the interchange fees directly to credit card users.[157] Instead, the merchants disperse the interchange fees to all consumers, even though many low-income customers do not use a credit card.[158] Thus, New York merchants are impeded from allocating the heightened cost fairly to their customers.[159]

The justifications for the state legislation are undermined when their practical effects are studied.[160] New York's "bait and switch" justification can be achieved through enforcement of current legislation, while little evidence exists to support that merchants are charging unfairly high prices.[161] In light of these consequences, the Second Circuit should overturn New York's Surcharge Ban so that merchants can fully exercise their First Amendment rights and allocate heightened costs to the correct customers.[162] Otherwise, New York will undermine not only the First Amendment's "bedrock principal,"[163] but also this country's innate belief that every person should have the chance to manifest their economic destiny.

PETER J. CLINE*

156. N.Y. GEN. BUS. LAW § 518 (McKinney 2010).

157. Brief for Petitioner, *supra* note 62, at 6.

158. Brief for Petitioner, *supra* note 62, at 6.

159. Brief for Petitioner, *supra* note 62, at 6.

160. Brief for Petitioner, *supra* note 62, at 10–12 ("[T]he State's objectives can be achieved through alternative, less restrictive interventions.").

161. Brief for Petitioner, *supra* note 62, at 11–12.

162. Brief for Petitioner, *supra* note 62, at 13 ("[Section 518] acts as an anti-disclosure law by forcing merchants to keep consumers in the dark about the true cost of credit card usage.").

163. Texas v. Johnson, 491 U.S. 397, 414 (1989) ("If there is a *bedrock principle* underlying the First Amendment, it is that the government may not prohibit the expression of an idea simply because society finds the idea itself offensive or disagreeable.") (emphasis added).

*I am especially grateful to my family for their love and support. Mom, Dad, Ashley, and Morgan, thank you for always being there through thick and thin.