UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

EXPRESSIONS HAIR DESIGN, et al., Plaintiffs, v. ERIC T. SCHNEIDERMAN, in his official capacity as Attorney General of the State of New York Defendant.	**13 Civ. 3775 (JSR)** **ECF Case**

MEMORANDUM OF LAW OF *AMICI CURIAE* THE KROGER CO., SAFEWAY INC., WALGREEN CO., FOOD LION, LLC, HY-VEE, INC., H.E. BUTT GROCERY COMPANY, THE GREAT ATLANTIC & PACIFIC TEA COMPANY, INC., ALBERTSON'S LLC AND RITE AID CORPORATION IN SUPPORT OF PLAINTIFFS' MOTION FOR PRELIMINARY INJUNCTION

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I. Statement of Amici Curiae Interests

This brief is filed on behalf of Amici Walgreen Company, The Kroger Co., Safeway Inc., Food Lion, LLC, Hy-Vee, Inc., H.E. Butt Grocery Company, Stop & Shop Supermarket Company LLC, The Great Atlantic & Pacific Tea Company, Inc., Albertson's LLC and Rite Aid Corporation, each of whom incurs many millions of dollars every year in "merchant discount fees" – the per- transaction fees that credit card companies charge a merchant every time a credit card is swiped and are an undisclosed contributor to the cost of goods purchased. These hidden fees contribute to the price for goods and services being higher than they would be if merchants were able to clearly express to consumers the presence of merchant discount fees and disclose viable options that would lower fees and thereby prices to the consumer. The New York statute being challenged in this action, N.Y. Gen. Bus. Law §518, prevents Amici and other merchants from expressing to their customers an economic proposition under which the merchant would ask its credit card using customers to pay a discrete fee, or "surcharge," if they insist on using a high fee credit card, which is expensive to the merchant. Amici are particularly well-suited to address the competitive value of surcharging – and the public interest in allowing merchants to communicate to their customers a proposition that is framed expressly in terms of surcharging -- for several reasons.

At the outset, Amici are large businesses which, unlike smaller merchants, have the opportunity to negotiate merchant agreements and merchant discount rates directly with banks and credit card companies. The ability to surcharge credit card transactions – and the ability to *threaten* to surcharge in negotiations with credit card networks – provides a demonstrably effective constraint on discount rates. Second, Amici have been in the vanguard of federal antitrust litigation challenging the no-surcharge rules of the major credit card networks. They

and their counsel understand the role that surcharging has played in constraining cost, in those countries where surcharging is permitted. Amici have a wealth of expertise regarding both the efficacy of framing the price difference between cash and credit as a "surcharge" and the difficulties associated with framing that same difference as a cash "discount," and can speak directly to why merchants should not be foreclosed from using the "surcharge" label in New York.

II. Introduction - Merchant Discount Fees And The Lack of Price Competition

Like virtually all U.S. consumer-facing businesses, Amici accept credit cards. Non-acceptance of any of the major credit card brands is simply not a viable business option for supermarkets and chain drug stores such as Amici. Across all industries, the vast majorities of U.S. retail transactions are consummated by credit or debit card.[1] In 2011 alone, $2.14 trillion dollars in commerce were transacted on credit cards and over $2.05 trillion dollars were transacted on debit and prepaid cards.[2]

Merchants incur fees, referred to as "merchant-discount fees" (and more colloquially as "swipe fees") on transactions paid for with a payment card. Each year, U.S. merchants pay more than $50 billion dollars in merchant discount fees to the major credit card networks and their bank partners. The typical merchant-discount fee on a credit card transaction in the U.S. is between 2% and 3% of the transaction amount, while fees on high-rewards cards can be higher. This means that if a sales ticket totals $100 and a customer pays with a credit card, the average merchant only receives between $97 and $98.

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[1] Oz Shy, "Trends in Consumer Payments," Federal Reserve Bank of Boston presentation, October 3, 2012, p. 13.

[2] The Nilson Report, February 2012, Issue 988, p. 8.

In many industries (including those represented by Amici), merchant discount fees are among the greatest operating expenses incurred by a merchant. Over the years, U.S. merchants have seen these fees increase. From 2000 to 2006, the average cost of accepting credit cards in the United States rose 123%.[3] In contrast, during roughly that same time period, merchant discount fees declined outside of the United States.[4] In countries where merchants have the ability to pass along the costs of accepting credit cards directly to those customers who chose to use a credit card, merchant discount fees are significantly less than what American businesses pay. [5] To take one prominent example, in the decade since the Reserve Bank of Australia invalidated payment card network bans on merchant surcharging, American Express's average discount fees have dropped from roughly 2.5% to roughly 1.8%, whereas they have stayed constant in the U.S. over that time frame.[6]

To date in the U.S., merchants have lacked the tools to induce credit card companies to drop their fees. Most significantly, merchants have been precluded by the "no-surcharge rules" of the major credit card networks from using ordinary price signals to steer customers to lower cost payment forms. As a consequence, Amici and other U.S. merchants have fought long and hard to force the dominant credit card networks to rescind their contractual no-surcharge rules, challenging those rules as illegal restraints of trade. After eight years of litigation, Visa and

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[3] Elizabeth Warren, "Antitrust Issues in Credit Card Merchant Restraint Rules," Discussion Paper for the Tobin Project Risk Policy Working Group, May 6, 2007, p. 2.

[4] Stuart E. Weiner and Julian Wright, "Interchange Fees in Various Countries: Developments and Determinants, "Federal Reserve Bank of Kansas City, Working Paper 05-01 (September 6, 2005), p. 14.

[5] It bears noting that in no fewer than twenty countries, including Australia, Spain and the United Kingdom, public authorities have taken action to ensure that merchants have the right to surcharge credit card transactions. Fumiko Hayashi, "Public Authority Involvement in Payment Card Markets: Various Countries, August 2012 Update," Payment Systems Research Department, Federal Reserve Bank of Kansas City, pp 9-10.

[6] RBA, Table C2, Market Shares of Credit and Charge Card Schemes, http://www.rba.gov.au/payments-system/resources/statistics/index.html

MasterCard both eliminated their no-surcharge rules as part of a settlement, with the rules revision going into effect January 27, 2013. However, for merchants doing business in New York, the current no-surcharge law means that merchants conducting business in this state cannot avail themselves of the cornerstone relief in that historic settlement – rescission of the Visa and MasterCard no-surcharge rules.

The New York no-surcharge law has now stepped into the shoes of the former anticompetitive rules of Visa and MasterCard. This law prohibits merchants from communicating transparent price signals at the point of sale to steer credit card-using customers to less expensive payment forms, like debit cards or cash, and protects the credit card companies from having to engage in price competition with respect to merchant discount fees. Armed with the ability to employ price signals, large merchants like Amici can use the threat of communicating the cost of credit card usage directly to the consumer in order to negotiate lower rates with the credit card companies, creating savings that are passed on to consumers in the form of lower prices. Consumers respond to price signals when they perceive them. When merchants have the ability to steer customers to cheaper forms of payment, such as debit cards or cash, through clear transparent choices, the credit card companies will need to compete with these less expensive payment forms, and to price credit card merchant fees accordingly. Moreover, merchants will be able to compete with one another on the dimension of whether and how to price for payment card acceptance services – *e.g.*, to engage in the sort of competition that hotels do when they decide whether to charge for in-room Wi-Fi, or for parking, and what price to charge for those services.

III. "Surcharges" versus "Discounts"

A. The Effectiveness of "Surcharges"

Currently under the protection of the New York No-Surcharge Statute, the "discount fees" are hidden from the consumer. There is little debate regarding the efficacy of surcharging as a direct communication that exposes hidden fees and incentivizes customer behavior. When customers are faced with even a relatively small surcharge for using an expensive credit card, the shift to a different non-surcharged payment product is dramatic and immediate. Empirical evidence from Australia, where surcharging is permissible, shows that a majority of consumers faced with a small surcharge will switch to a non-surcharged product.[7] Likewise, an empirical study submitted by MasterCard in proceedings before the United Kingdom's Office of Fair Trade, found that the imposition of a 2% surcharge on customers who use a credit card to buy groceries shifted 55% to 71% of the sales volume away from credit cards to alternative payment methods.[8]

Notably, the empirical evidence has also shown that, while surcharging is very effective in reducing credit card transactions, it causes few lost sales. When a merchant expressly communicates that it is imposing a "surcharge" on credit card transactions, as opposed to offering a discount on debit or cash, then switching payment methods is by far the predominant consumer response. Research in behavioral economics shows that when a charge is communicated as the result of increased costs to a merchant, customers perceive the charge as

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[7] Reserve Bank of Australia, "A Variation of the Surcharging Standards: Final Reforms and Regulation Impact Statement, June 2012, p. 3.

[8] "Investigation of the multilateral interchange fees provided for in the UK domestic rules of MasterCard UK Members Forum Limited (formerly known as MasterCard/Europay UK limited)," Decision of the Office of Fair Trading, Sept. 5, 2005, p. 76. See also Reserve Bank of Australia, "Reform of Australia's Payment Systems: Preliminary Conclusions of the 2007/08 Review," April 2008, p. 18 ("[W]hen surcharges are imposed on a particular type of card, use of that card declines substantially").

fair and are willing to pay the extra charge or switch to a lower-cost payment form without negatively viewing the merchant.[9]

B. The Ineffectiveness of "Discounts"

There is little doubt that framing the cost difference between cash (or debit) and credit as a "discount" for cash —even when the price difference is exactly the same—is significantly less effective than imposing a "surcharge" for credit, in impacting a customer's choice of payment methods. Surcharging at the point-of-sale, with its perceived immediacy and invocation of customer loss aversion, has a greater influence on a customer's choice of payment form than other incentives such as discounting.

It is a fundamental tenet of behavioral economics that losses loom larger than corresponding gains and there is a wealth of academic literature documenting "the empirically demonstrated tendency for people to weigh losses more significantly and more heavily than gains."[10] Thus, consumers are much more motivated to avoid a surcharge on a particular payment form than they are to obtain a discount of similar magnitude on another form of payment. A useful example was described in research that surveyed Dutch consumers on their attitudes about credit card surcharges and cash discounts. The results of that research found that 74% of those surveyed had a negative or strongly negative association with credit card

[9] Daniel Kahneman, Jack L. Knetsch and Richard Thaler, "Fairness as a Constraint on Profit Seeking: Entitlements in the Market," The American Economic Review, Vol. 76, No. 4:728-741 (September 1986) ("Kahneman, Knetsch and Thaler (1986)"), pp. 732-735; Richard H. Thaler, "Mental Accounting Matters," Journal of Behavioral Decision Making, Vol 12, No 3:183-206 (1999), p. 189.

[10] Richard H. Thaler and Shlomo Bernartzi, "Save More Tomorrow™; Using Behavioral Economics to Increase Employee Saving," Journal of Political Economy, Vol. 112, No. S1:S164-S187 at S169 (February 2004). See also, Daniel Kahneman, and Amos Tversky, "Prospect Theory: An Analysis of Decisions Under Risk," Econometrica, 47 (2), 263-91. Daniel Kahneman, Jack L. Knetsch and Richard H. Thaler, "Anomalies: The Endowment Effect, Loss Aversion and Status Quo Bias," The Journal of Economic Perspectives, Vol. 5, Issue 1 (Winter 1991) at 193-206.

surcharges while only 22% of the sample had a positive or strongly positive opinion about a cash discount.[11]

IV. N.Y. Gen. Bus. Law §518 Bars Price Signals And Restricts Free Speech

The restrictions on Amici's ability to use the language of surcharging are antithetical not only to the values of the First Amendment – as Plaintiffs have argued – but also to the public interest in promoting price competition. As the Supreme Court has recognized, commercial speech is critically important not only to speakers and recipients of speech, but to the functioning of a free enterprise economy. *See Bates v. State Bar of Ariz.*, 433 U.S. 350, 364 (1977) (commercial speech "performs an indispensible role in the allocation of resources in a free enterprise system"). Clearly, the "heart of our national economy long has been faith in the value of competition." *Nat'l Soc. of Prof'l Engineers v. United States*, 435 U.S. 679, 695 (1978). "[U]ltimately competition will produce not only lower prices, but also better goods and services." *Id.*

The Supreme Court recognizes that the dissemination of price signals is an essential form of commercial speech. *See Virginia State Board of Pharmacy v. Virginia Citizens Consumer Council, Inc.,* 425 U.S. 748, 764-65 (1976) (commercial speech includes dissemination of price information); *see also Central Hudson Gas & Elec. Corp. v. Public Service Commission of New York,* 447 U.S. 557, 580 (1980) (Stevens, J., concurring) (commercial speech includes "a manufacturer's publication of a price list"). A rule that bans the use of price signals is a rule that bans the use of speech.

The restrictions in N.Y. Gen. Bus. Law §518 fundamentally interfere with price transparency and the efficient functioning of the market. In an efficient market, prices carry

[11] E. Vis and J. Toth, "The Abolition of the No-Discrimination Rule," Project No. R231 (March 2000), p. 15.

information as to the value and costs of a goods and services. No-surcharge laws (which really ought to be called "no price laws") flatly thwart that function; they prevent merchants from using the price mechanism to inform customers of the relative costs of their chosen means of payment. The elimination of pricing information at the point of sale, moreover, all but guarantees an inefficient allocation of resources; the market's 'invisible hand' cannot function when buyers are not provided with appropriate information and incentives to guide their decisions.

The no-surcharge laws ensure that high merchant discount fees are hidden from consumers. Amici have a strong interest in ensuring that their customers receive real information regarding the costliness of various payment products, and the only way to meaningfully convey that information is via price signals. Armed with accurate information, consumers can make appropriate choices. Indeed, the right of consumers to receive accurate information is a core value in the Supreme Court's commercial speech jurisprudence: "[T]he extension of First Amendment protection to commercial speech is justified principally by the value to consumers of the information such speech provides . . . ." *Zauderer v. Office of Disciplinary Counsel of Supreme Court*, 471 U.S. 626, 651 (1985). Accord, *Va. Bd. of Pharmacy v. Va. Citizens Consumer Council, Inc.*, 425 U.S. 748, 757 (1976) (Just as advertisers have a First Amendment right to distribute advertising, consumers have a "reciprocal right to receive the advertising"); *Pruett v. Harris Cnty. Bail Bond Bd.*, 499 F.3d 403, 415 n.35 (5th Cir. 2007) ("The benefits attending commercial speech flow not just to the speaker, for increased consumer knowledge about any product aids consumer choice and increases competition.") Moreover, as the Court noted in *Virginia Board of Pharmacy,* consumers' interest in receiving commercial information "may be as keen, if not keener by far, than his interest in the day's most urgent political debate." 425 U.S. at 763.

V. Conclusion

The State of New York allows merchants to charge for merchant discount fees as long as the merchant does not delineate the extra costs as a surcharge. Merchants can discount for customers with cheaper forms of payment and thereby charge consumers with expensive cards more as long as the merchant does not tell the consumer that the increased prices are connected to the expensive card. Merchants should be able to be transparent and open with their customers and communicate clearly and effectively their displeasure with expensive cards for the benefit of all of their customers and to the broader benefit of consumers as a group. Free speech requires no less.

At least when the dominant credit card networks banned surcharging they had a discernible (if not admitted) objective: to insulate themselves from competitive forces and give themselves a free hand to set merchant fees at rates that would be unthinkable in much of the rest of the world. When the legislature of New York makes it illegal to frame an economic transaction as a surcharge, however, the objective is anything but clear. Presumably, the State is concerned that consumers will make bad decisions if they are armed with accurate information. But the Supreme Court has always rejected commercial speech restrictions 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 (2002); see *Virginia Board of Pharmacy*, 425 U.S. at 765 ("people will perceive their own best interests, if only they are well enough informed, and … the best means to that end is to open the channels of communication rather than to close them. It is precisely this kind of choice, between the dangers of suppressing information, and the dangers of its misuse if it is freely available, that the First Amendment makes for us.")

For all the foregoing reasons, and those set forth in the Plaintiffs' memorandum of law in support of their motion for a preliminary injunction, Amici respectfully request that the Court enjoin enforcement of the New York's no-surcharge law, N.Y. Gen. Bus. Law §518.

Date: New York, New York
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Respectfully submitted,

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