According to applicable state laws and the Visa and MasterCard network rules, a surcharge is an additional fee that a merchant adds to a retail transaction when a consumer uses a credit card for payment. Ten states have laws that prohibit the practice of surcharging. And, historically, the respective card networks had also prohibited surcharging. But that changed in early 2013 when the networks were required to modify their restrictions based on settlement of a class action lawsuit initiated by a group of merchants in 2005. While the networks' rules now permit surcharging, they do so with specific restrictions and requirements.

As a result, the environment around surcharging – including an understanding of what is and is not a surcharge – has become quite murky. In this document, PayLease articulates the issue of surcharging and clarifies how the state laws and card network rules apply to its business.

The PayLease Business

PayLease is a software and services company that facilitates the movement of rent and homeowners association (HOA) payments from residents to their property managers through the Internet, telephone, remote deposit capture (RDC) – also called check scanning – and cash at third-party agent locations.

For transactions conducted on the Internet – the company's largest payment channel – PayLease provides a front-end payment interface, which is typically integrated with a property manager's website and accounting system. The system accepts resident payments made via e-check/Automated Clearing House (ACH) or major card (Visa, MasterCard, American Express and Discover) and facilitates movement of funds from the payer's account to a property manager's account.

Property managers receive the same amount of funds regardless of whether payment is made directly to the landlord by cash or check, or through the services provided by PayLease. Property managers do not share in any fees paid by consumers to PayLease for its payment processing services.

Also, PayLease's services are entirely separate from the services provided by property managers to their residents. Whereas a lease or HOA agreement establishes the services provided by a property manager to a resident, those residents who choose to use PayLease agree to a separate set of terms and conditions with PayLease. This agreement establishes the terms on which PayLease will provide its payment services, independent of any other services. PayLease's services include: access to internet and telephone payment channels, 24-hour customer service by staff dedicated to participating residents, integration with the property manager's website so that residents are not required to visit a third-party site, and the ability to choose from a variety of payment options either monthly or on an ongoing basis. Property management companies use PayLease to provide their residents with optional channels – *outside of their traditional cash and check channels* – for making rent and HOA payments. PayLease saves its clients the time and expense of setting up merchant accounts for accepting credit payments, complying with costly Payment Card Industry (PCI) card acceptance requirements, and provides residents with more choices to address their payment and lifestyle needs.

A good analogy for the services provided by PayLease are overnight delivery companies, such as FedEx, UPS or the U.S. Postal Service. Akin to PayLease, consumers pay a fee to send a letter, check or package, which is delivered to a designated recipient through the overnight company's proprietary network. With PayLease, consumers pay a fee to send funds through its proprietary network. But rather than delivering a physical document – a check – PayLease delivers funds and data electronically.

PayLease and the State Credit Card Surcharge Laws

The following 10 states have laws that prohibit credit card surcharging:

- *California (see below)*
- Colorado
- Connecticut
- Florida (see below)
- Kansas
- Maine
- Massachusetts
- *New York (see below)*
- Oklahoma
- *Texas (see below)*

The state laws – many of which use similar language – prohibit a seller or lessor in any sales or lease transaction from imposing a surcharge on a consumer who elects to use a credit card in lieu of payment by cash, check or similar means. However, the same laws – either expressly or through regulation – recognize the distinction between surcharging and discounting, and permit merchants to provide a discount for inducing payment by cash, check or other means not involving the use of a credit card. Consistent with these laws, PayLease provides a discount in the charges for its services if the consumer pays by ACH, rather than charging a fee (surcharge) if the consumer pays PayLease's service fee by credit card.

Surcharge vs. Discount

The central issue is whether the difference in fees charged by PayLease for transactions made by payment card versus an ACH debit is a surcharge. While the state laws go no further in defining the term "discount," the Federal Truth in Lending Act – which protects consumers against unfair credit billing and credit card practices – provides that the "regular price" of a service is the credit card price if the provider of the service posts both a credit price, and a price for payment by electronic check.

The PayLease system posts a price if a consumer uses a payment card and another if the consumer pays by ACH. Accordingly, the difference between the two service fees is a discount for paying by ACH rather than a surcharge for using a payment card, and is permitted in all 10 states.

Texas

In June 2015, the Texas Office of Consumer Credit Commissioner (OCCC), which regulates the Texas credit card surcharge law, issued an advisory bulletin – *Credit Card Surcharge Advisory Bulletin: Alternatives to Credit Card Surcharges* – which permits third-party payment processors to assess higher fees for credit card transactions than other forms of payment under three conditions. Language from the OCCC advisory bulletin follows:

> ***5. Third-party payment processor***
> *Sellers may contract with a third-party payment processor to accept payments by credit card. The processor may charge a fee that is higher for credit cards if the following three conditions are met.*
>
> *First, the seller may not receive any portion of the fee charged by the processor, or any direct or indirect benefit from the fee (e.g., a discount on other services from the processor). If a processor imposes a greater fee for credit cards than for other forms of payment, and the seller receives a portion of this fee, then the seller is effectively imposing a credit card surcharge on the buyer.*
>
> *Second, there must be an arm's-length relationship between the seller and the processor, limited to processing payments. If the processor has a continuing business relationship with the seller, then the relationship should be limited to the processing of payments. If the relationship goes beyond the processing of payments, or if the parties have a general-agency or joint-venture relationship, then the seller would effectively be imposing a credit card surcharge.*
>
> *Third, multiple payment channels must be available to the buyer. The buyer must not be required to pay the processor's fee. If the seller requires the buyer to make payments through the processor and the processor requires the buyer to pay a greater fee for credit cards than for other forms of payment, then the seller is requiring the buyer to pay a credit card surcharge.*

PayLease meets all three conditions detailed in the bulletin, which also recognizes the company's discount position as described earlier.

Constitutional Challenges

Credit card surcharge prohibitions have been challenged on constitutional grounds in four key states: California, Florida, New York and Texas. Groups of merchants in each of these states have sued to enjoin (block) the respective laws claiming they restrict freedom of speech and are unconstitutionally vague. The status of these lawsuits follows:

In November 2015, the U.S. Court of Appeals for the 11th Circuit ruled that the Florida credit card surcharge law amounted to an abridgement of free speech that violated the First Amendment. The ruling reversed a prior federal district court's decision, which had upheld the law.

In September 2015, the U.S. Court of Appeals for the 2nd Circuit revived the New York credit card surcharge law, ruling that a federal district court judge had erred in finding the law unconstitutional. The court ruled that the state's surcharge ban does not violate merchants' freedom of speech or due process rights under the U.S. Constitution.

In March 2015, the Chief Judge of the U.S. District Court for the Eastern District of California declared California's surcharge law unconstitutional and permanently enjoined its enforcement. The judge ruled that the law amounts to an unconstitutional restriction on free speech and is unconstitutionally vague. The ruling has been appealed is being heard by the U.S. Court of Appeals for the 9th Circuit.

In February 2015, a federal district court dismissed a lawsuit that challenged the constitutionality of the Texas credit card surcharge law. The decision is being appealed.

Based on opposing decisions in two circuits of the U.S. Court of Appeals, the U.S. Supreme Court agreed to hear the case, which it did on January 10, 2017. A decision is pending.

PayLease and the Card Network Rules

PayLease is registered with Visa, MasterCard and American Express as a third-party Payment Services Provider (PSP). This is a category of companies that work with individual sub-merchants, which do not traditionally accept cards as payment mechanisms for their goods and services. PSPs accept credit cards and process payments – and perform a host of other services – on behalf of their sub-merchants.

As a PSP, PayLease charges fees for its transaction processing services, which are typically passed through to residents. While card network rules around surcharging and convenience fees are fairly restrictive, they recognize that the Truth in Lending Act gives a merchant the right to provide consumers a discount as an inducement for the consumer to pay by cash, check or similar means. Following is language from Visa's International Operating Regulations (April 15, 2014):

> ***Chapter 6: Payment Acceptance***
>
> ***Core Principle 6.2***
>
> *Honor All Cards Properly Presented Honoring All Visa Cards*
>
> *… Merchants may attempt to steer customers who initially present a Visa card to an alternative method of payment, such as by providing discounts for cash, but may not do so in a confusing manner that denies consumer choice. …*

Visa Rules also recognize that the Durbin Amendment, which was passed as part of the Dodd-Frank financial reform legislation in 2010, gives merchants broad rights to offer discounts for payment by the use of cash, checks, debit cards or credit cards, as long as the discount:

- Does not differentiate on the basis of the issuer of the card or payment network, and
- Is offered to all prospective buyers and disclosed clearly and conspicuously, to the extent required by applicable federal and state law.

PayLease is offering a discount for paying by ACH rather than a surcharge for using a payment card, which is permissible under the card network rules.

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