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Name that Fee - Exploring the Legality of Surcharges, Service Fees, and Convenience Fees

There are a number of different ways for businesses to attempt to recoup costs charged by credit card processors and issuers for each credit card transaction entered into by such businesses. The three primary methods employed for recouping these credit card fees are: (1) a surcharge; (2) a convenience fee; and (3) a service fee. These methods are all similar; however, the legality of employing these methods to recoup credit card fees varies from state-to-state and largely depends upon the method used by the business.

Overview of the Fees

In deciding which method to pursue, it is important to discern how surcharges, convenience fees, and service fees differ from one another.

Surcharges are fees added to the cost of a purchase simply for the “privilege” of using a credit card in the transaction. Surcharges usually are calculated based on a percentage of the value of the transaction.

On the other hand, convenience fees are fees charged for the “convenience” of using an alternate channel of payment that is atypical for the seller. For example, a seller or service provider might charge a convenience fee when allowing a customer to pay with a credit card over the internet where the seller’s usual payment method is face-to-face. The key difference between a surcharge and a convenience fee is that the surcharge is added on all credit card transactions, whereas a convenience fee is only included on transactions that are atypical for a particular seller.

Finally, service fees are used in conjunction with “cash discount” programs. Cash discount programs apply a small customer service fee to all transactions then waive or remove the fee if the customer pays with cash, i.e., the cash discount. Cash discount programs are generally required to detail the service fee and cash discount in the receipt of the transaction. These programs are not considered surcharges because they do not add a new fee to credit card transactions *per se*. Further, service fees differ from convenience fees because they have nothing to do with accepting an alternate method of payment that is atypical to the seller.

The Legality of the Fees

The legality of recouping credit card costs by passing the cost along to the customer depends on: (i) the regulations of the state in which the business is located; (ii) the contract between the business and credit card company; and (iii) the particular method employed by the business to recoup credit card costs. Many states take differing stances on the legality of recouping costs by charging a fee to the customer, varying from no regulation whatsoever to an outright ban.

For example, in Pennsylvania, West Virginia, and Delaware, there are no regulations that apply to fees associated with credit card use by consumers. As such, the practice of recouping credit card costs via any of these methods is neither regulated nor prohibited. However, many credit card companies previously included provisions in their contracts that prohibited businesses from passing these costs on to their customers via surcharge in turn. After a major class action lawsuit in 2013, Visa, MasterCard, American Express, and Discover ended their “no-surcharge” policy. Even though surcharges are not outright prohibited by the credit card companies today, there are typically

rules contained in the contract with the credit card company that the businesses must follow to legally impose a surcharge on their customers.

On the other end of the spectrum, New York has regulations that apply to fees associated with credit card use by consumers. New York's regulation prohibits businesses in any sales transaction from imposing a surcharge on a buyer who elects to use a credit card as his or her method of payment. While this regulation explicitly uses the term "surcharge," it has been interpreted by the Courts in New York to encompass the general practice of charging an additional fee or higher price to consumers utilizing a credit card for payment. However, the regulation does not prohibit the use of a service fee in conjunction with a cash discount program. Sellers that violate New York's regulation are subject to a \$500 fine, a one-year term of imprisonment, or both.

Significantly, the constitutionality of New York's regulation is currently being challenged by various businesses. This serves to illustrate the fluid and ever-changing nature of the law.

Moving Forward

In assessing the manner to recoup credit card costs, businesses must be well-informed and up-to-date on the applicable regulations and case law pertaining to the method they employ to accomplish their goals. Further, businesses also must be aware of the terms in their contracts with the credit card companies that govern their ability to pass the cost of the credit card fees to their customers. Our recommendation is to review the relevant regulations and case law, as well as the applicable credit card company contracts, to determine the best method for recouping costs imposed by credit card processors. The service fee appears to be the safest method with the least legal hurdles to overcome, but it is still important for a business considering adding such a fee to thoroughly research the relevant law in the jurisdiction(s).

For more information about recouping costs charged by credit card processors or service fees in general and/or for your specific business and situation, please contact us.



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