Data Breach - Litigation Update

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Agenda

- **Data Breaches – Where Are We?**
- **Class Action Defenses – The Lay of the Land**
  - Article III standing
  - Causation and other defenses
  - Class certification defenses
- **Recent Class Action Settlements**
- **What's Coming?**

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Data Breaches – Where Are We?

- Data breaches more common, bigger, and more expensive than ever
- Data security concerns have doubled since 2008
- Common: 1.5 million monitored cyber attacks in 2013; more than 1300 reported breaches.
- Bigger: largest breaches affect hundreds of millions of individuals. Target – 40M, Home Depot – 56M, Adobe – 38M, JP Morgan – 76M, Sony – 100M
- Almost 900 million records reported to have been compromised since 2005 (Privacy Rights Clearinghouse)

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Data Breaches – Where Are We?

- Average cost of data breach is $5.9 million and $201 per compromised record (2014 Ponemon Study)
- Average cost for crisis services, including forensics, notification, legal guidance, etc. is $366,484
- Average cost for legal defense is $698,797
- Average cost for legal settlement is $558,520

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Data Breaches – Where Are We?

- **Consumer study on breach notification**
  - 62% said breach notification decreased trust and confidence in organization
  - 15% would terminate relationship with notifying company; 39% would consider terminating
  - 94% believe reporting organization is solely responsible for breach
  - 72% believe organizations do a poor job communicating and handling a data breach

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Data Breaches – Where Are We?

- Chance, on average, of a data breach occurring at a given U.S. company over next two years, involving at least 10K records – 20%. Greatest likelihood for entities in the public sector and retail industry

- The inevitability of the "click"

- Calculate risk factor: https://databreachcalculator.com

- (Source: Ponemon Institute 2014 Cost of Data Breach Study)

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Data Breaches – Where Are We?

- **The Climate: Increasing Regulation**
  - Existing federal laws and regulations are industry- or data-specific: e.g., HIPAA (healthcare), Gramm-Leach-Bliley (financial services), FISMA (federal government), HITECH (healthcare; state AG enforcement of HIPAA).
  - FTC: enforcement of section 5 of FTC Act, prohibiting unfair or deceptive acts or practices
  - At least 35 federal laws with data or privacy protections
  - State laws: breach notification laws in place in 47 states, D.C., Puerto Rico, Virgin Islands and numerous countries
    - Residence of affected individuals determines applicable notice law in most instances
    - Federal breach laws recently proposed to supersede state laws

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Data Breaches – Where Are We?

- Congress has considered law embodying national standards for data breach notification, but nothing has emerged to date.

- Payment Card Industry Data Security Standards (PCIDSS). In place since 2006, updated in 2008. Applicable to all companies participating in the credit/debit card networks. Entities failing to comply can be fined, have rates increased for transactions, or have authorizations to process payment cards revoked. PCIDSS frequently invoked as the "standard of care" in consumer breach litigation

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Data Breaches – Where Are We?

- **Examples of penalties for non-compliance:**
  - Up to $750,000 in penalties for failure to notify affected individuals
  - Up to $50,000 per violation for consumer health information retained on a hard drive (HIPAA)
  - Private civil actions under state privacy statutes
  - Under HIPAA, failure to properly erase consumer health information can carry a minimum prison term of one year
  - Derivative suits
  - Class actions

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Breach Class Actions

- Class actions typically follow large breaches
- Typically, brought on behalf of consumers whose data has been, or is alleged to have been, stolen or lost
- Consumers generally alleging some combination of three injuries: (a) cost to them of subsequent fraudulent transactions; (b) increased risk of future identity theft; (c) burden of closing affected accounts and opening new ones

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Breach Class Actions

- **Data breach cases are almost always class cases, not individual actions**
  - Nominal or very limited damages
  - No generally applicable statutory remedy: no statutory damages or attorneys' fees
  - Threat of huge number of individual actions not very credible
  - Cases pleaded to maximize damages and minimize individual issues

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Breach Class Actions – Theories of Liability

- Common law: negligence, express or implied contract, unjust enrichment, fraud/misrepresentation, invasion of privacy, bailment

- State consumer fraud or consumer protection statutes/ breach notification statutes

- Federal statutes: Fair Credit Reporting Act, etc.

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Breach Class Actions – Where We Are Legally

- In general, and with some exceptions, the law is developing favorably for defendants

- Several substantive defenses have been mostly well received in consumer breach cases: Article III standing; lack of actionable injury or damage; causation (still emerging)

- Profitable class certification defenses: factual predominance, legal predominance, ascertainability

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Breach Class Actions – Where We Are Legally

- **Jurisprudence in issuing bank cases less developed**
- **Some potentially profitable substantive and procedural defenses, however:**
  - No duty
  - Dispute governed by card companies' operating rules and regulations (including potential arbitration, justiciability and primary jurisdiction defenses)
  - Economic loss rule
  - As to class certification: predominance of individual factual and legal issues; ascertainability; superiority

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Breach Class Actions – Article III Standing

Plaintiff's injury must be "concrete and particularized" and "actual and imminent"

Supreme Court's decision in *Clapper* (113 S.Ct. 1138) (2013) strengthened defense arguments

- threat of future injury alone found to be too speculative; harm must be "certainly impending"

- plaintiffs can't manufacture standing by choosing to make expenditures based on hypothetical, non-impending future harm

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Breach Class Actions – Article III Standing

- Majority of district courts have dismissed data breach complaints post-Clapper for lack of standing
- Generally, increased risk of identity theft not enough and speculation of future injury insufficient
- Leading/recent cases:
  - Whalen v. Michael Stores Inc. (EDNY Dec. 2015)
  - Antman v. Uber Tech, Inc. (ND Cal Oct. 2015)
  - In re Zappos.com, Inc. (D. Nev. June 2015)

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Breach Class Actions – Article III Standing

- **Seventh and Ninth Circuits**
  - Krottner v. Starbucks Corp. (9th Cir. 2010) (theft of laptop from Starbucks containing PII of 97K employees; held that plaintiffs "have alleged a credible threat of real and immediate harm stemming from the theft of a laptop containing their unencrypted personal data"); most courts have held that Krottner survives Clapper (see, e.g., In re Sony Gaming Neworks (SD Cal. 2014)
  - Remijas v. Neiman Marcus Group (7th Cir. 2105) (class held to have standing following hack, though no actual identity theft was alleged, "because there is an objectively reasonable likelihood that such an injury will occur")

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Breach Class Actions–Article III Standing

- **Based on dicta in *AmChem* and *Ortiz*, plaintiffs have begun arguing that standing determinations can be deferred until after class certification**
  - Those cases decided in other contexts
  - Standing decisions – which implicate jurisdiction – shouldn't be deferred if based on the pleadings
- **The Target court adopted this rationale; other courts (e.g., In re Anthem Data Breach Litig., ND CA 2016) have held that the timing of these determinations is discretionary**

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Breach Class Actions – Article III Standing

- **Allegations of actual data misuse or identity theft much more likely to confer standing**
  - *Resnick v. AvMed* (11th Cir. 2012) – sufficient to plead that plaintiff was victim of identity theft and had suffered (unspecified) monetary damages as a result
  - *Lambert v. Hartman* (6th Cir. 2008) – same
  - *Tierney v. Advocate Health* (N.D. Ill. 2014) – attempts to open account in plaintiff's name, together with allegation that plaintiff had never suffered another data breach, sufficient to confer standing

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Breach Class Actions – Article III Standing

- Once an actual injury in fact is plausibly alleged, other injuries (credit monitoring and the like) have been held to satisfy the injury in fact requirement, even if they would not have done so standing alone
- Examples:
  - Storm v. Paytime (MD PA 2015)
  - Longnecker-Wells v. Benecard Servs. (MD PA 2015)
- Upshot: one adequate plaintiff is enough to expose defendant to more remote categories of damages, and arguably to class members who don't themselves have standing

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Breach Class Actions – Article III Standing

- Other courts taking a more restrictive view
- *Burton v. MAPCO Express* (N.D. Ala. 2014): plaintiff must allege concrete financial injury to confer standing (for example, responsibility for fraudulent charges).
- Cost of credit monitoring (in absence of actual fraudulent transactions) generally held not to confer standing
- Burden of closing accounts, etc. also not enough
- *Burton* criticized by another court within that circuit, *Smith v. Triad of Alabama* (MD Ala. Sept. 2015)

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Breach Class Actions – Article III Standing

- **Claims by issuing banks less likely subject to successful standing challenge**
  - Able to allege concrete losses (fraudulent charges and cost of issuing replacement cards)
  - Nature of the banks' claims differs from that of consumers
  - Court in Target litigation rejected standing arguments as to issuing banks; "readily apparent" that banks who had to replace stolen cards had suffered injury in fact

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Breach Class Actions – Article III Standing

- **Why do these claims continue to be asserted?**
  - Attempts to "move the needle" on majority/minority view of standing
  - Issue unaddressed in some circuits
  - "Increased risk" claims have fewer class certification problems; very difficult to establish a class of people who have actually suffered identity theft or fraudulent transactions with common, non-individualized proof

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Breach Class Actions – Actionable Injury

- **Fine line between constitutionally-sufficient injury and tort-sufficient injury, but some courts are finding it**
  - Some courts uphold Article III standing but throw out the case for lack of actionable injury: *Pisciotta* (7th Cir. 2007), *Krotter* (9th Cir. 2010)
  - This the overwhelming trend when the only claimed damage is increased risk of identity theft or fraud, and no allegation or proof of concrete loss
  - Upshot: include both Rule 12(b)(1) (jurisdiction – Article III) and Rule 12(b)(1) (failure to state claim) in motions to dismiss

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Breach Class Actions – Causation Defense

- **Developing issue: can plaintiff prove that the breach caused the claimed loss?**
  - Note the specific pleading requirements in cases like *Resnick*, *Lambert (*6th Cir. 2008) and *Tierney*: can plaintiff prove what he has pleaded?
  - Where and when have they used their credit cards? Who have they given their personal information to?
  - Bleeds over into class cert defenses
  - One answer for plaintiffs may be common point of purchase reports submitted to card companies

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Breach Class Actions – No Duty Defense

- **Generally, under most states' laws, no duty to protect plaintiff from criminal acts of third party, absent special relationship**
  - A number of courts have tossed data breach cases on this ground, *see Hannaford Bros.* (D. Me.), *BancFirst* (W.D. Okla.), *Cumis Ins. Soc'y* (D. Ariz.)
  - Argument: no special relationship possible when underlying facts governed by contract (e.g., bank card regulations)
  - This argument rejected as to both consumer and financial institution plaintiffs in Target case
  - Still, worth developing and asserting

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Breach Class Actions – Defense to Bank Claims

- **Emerging defense: issuing banks contracted for their remedy through card company agreements, and can't sue independent of them**
  - Card agreements in certain circumstances may call for individual arbitration
  - Card agreements may make the card companies the sole interpreter of the agreements and accompanying regs
  - Under card agreements and regs, issuing banks contracted for a charge back system and shouldn't be able to avoid it by suing
  - Economic loss and related doctrines should confine banks to contractual remedies
  - Not raised in Target litigation

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Breach Class Actions – Class Cert Defenses

- Rule 23(a) requirements: numerosity, commonality, typicality, adequacy of representation
- Rule 23(b)(3) requirements: common questions of law or fact predominate over individual questions; and class treatment is superior to other methods for resolving dispute
- *Wal-Mart* and *Comcast* have tightened these requirements generally

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Breach Class Actions – Class Cert Defenses

- **While few breach cases have reached class cert stage, there are significant problems for plaintiffs:**
  - Predominance of individual factual questions
    - How can the fact of actual injury be shown by common proof?
    - Even if shown, class members' injuries almost certain to be individualized. *See, e.g., Hannaford Bros.* (D. Me. 2013)
    - *Comcast* decision highlights certification problems arising out of individualized damages
    - In proper cases, defendant may have mitigation-type arguments, also individualized

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Breach Class Actions – Class Cert Defenses

- **Will causation ever be a common question?**
  - In cases in which plaintiff is required to show an actual injury (as opposed to increased risk), causation likely to be individualized

    - Each class members' history with regard to his personal information becomes potentially relevant
    - Timing of the breach, together with other breaches, can be important
    - Consider this issue when embarking on discovery, as well as potential expert testimony
    - Unlike some other issues, causation can be a big problem for bank plaintiffs as well as consumers

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Breach Class Actions – Class Cert Defenses

- **To avoid predominance problems, some plaintiffs are attempting to bring claims for statutory damages**
  - Fair Credit Reporting Act – most defendants, however, are not "credit reporting agencies" and do not "furnish" information about their customers
  - Attempts being made under various state statutes (e.g., California UCL), thus far without success
  - Breach notification laws in many states allow for statutory damages; defendants will have to argue that failure to give notice did not cause injury
  - Will Congressional lawmaking affect this issue?

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Breach Class Actions – Class Cert Defenses

- Ascertainability: must be objective criteria for identifying class members
- Some courts have held that method of identifying must be "administratively reasonable"
- For breaches resulting from point-of-sale intrusions, and in instances where company does not store or retain consumer data, defendant may have no way of determining whose data was stolen
- Attempting to obtain identities from third parties will add to complexity, argues against superiority

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Breach Class Actions–Class Cert Defenses

- **3rd Circuit has recently retreated from robust ascertainability requirement, Carerra v. Bayer (2013)**
  - That there is no administratively feasible method of identifying class members is insufficient to defeat class certification
  - Class proper even though clearly both under- and over-inclusive
- **7th Circuit has gone even further in Mullins v. Direct Digital case (2015)**
  - All that is required is a clear class definition governed by objective criteria; no requirement that the class members be capable of being specifically identified at all

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Breach Class Actions - Settlements

- **Target (2015)**
  - Consumer class of 110M members; consumer class settlement, $10M settlement fund and $6.75M in combined attorneys' fees and expenses
  - Substantial non-monetary relief, including beefed-up security, monitoring, training
  - $67M settlement with Visa and Visa-issuing banks; $39M to Mastercard and MC-issuing banks, on claimed losses of $200M; payment of up to $20M in attorneys' fees to banks' lawyers
  - Both consumer and bank settlements are claims-made
  - Banks can elect to be paid $1.50 per reissued card or up to 60% of total fraud, reissuance or other costs incurred

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Breach Class Actions - Settlements

- **Heartland (2012)**
  - 130M consumer class members; settlement fund of $1M, plus commitment to contribute additional $1.4M if needed; $600K in attorneys' fees; non-monetary relief (principally remedial measures to systems)
- **Sony (2014)**
  - 24.5M class members, claims made settlement; $1M reimbursement cap plus $14M non-cash benefit cap; $2.7M total attorneys' fees and costs
- **AvMed (2013)**
  - 460K class members, settlement fund of $3M for payment of claims, notice/admin expenses, attorneys' fees and class representative awards

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Breach Class Actions - Settlements

- Certification for settlement purposes – need not meet the manageability requirement, potentially allows for creativity in crafting claims-made settlements
- Class actions, at least those not involving regulators or the government, have been settling pretty inexpensively (e.g., Heartland breach litigation)
- Note increasing challenges to *cy pres* relief and reverter clauses – courts want to make sure that defendant is parting with real value and the class is getting at least some relief

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Breach Class Actions – Where Are We Headed?

- While current climate favors defendants, recent developments (Target; standing decisions) suggest that the fight is not over
- Financial institution claims in the payment card industry likely to be more dangerous and more expensive
- Consumer claims remain inexpensive (on a per class member basis) to settle on class basis
- Most significant developments likely to be wrought by regulators and legislatures

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Breach Class Actions – Where Are We Headed?

- **Supreme Court has before it several issues that could have an impact**
  - Whether standing is conferred by a claim of a statutory violation standing alone
  - Use of statistical evidence at class certification
- **Recent vacancy on Court suggests that helpful clarity unlikely to be forthcoming, however**

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Questions?

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