Legal Backgrounder

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CLASS ACTIONS UNDER FACTA: LOTS OF ACTIVITY, BUT WHAT DO THEY ACTUALLY ACCOMPLISH?

by

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On December 4, 2003, Congress enacted the Fair and Accurate Credit Transaction Act (FACTA), which amended the Fair Credit Reporting Act (FCRA) to impose new obligations on merchants. FACTA requires merchants to truncate all but the last five digits of credit and debit card account numbers and prohibits the printing of card expiration dates on electronically printed customer receipts. For most merchants, FACTA became effective on December 4, 2006.

The plaintiffs' class action bar promptly filed a slew of purported class actions against merchants, large and small, alleging FACTA violations. While the wave of lawsuits started in California, there are now more than 250 FACTA class action complaints pending in at least a dozen states. Significantly, plaintiffs have not alleged any actual damages in these cases. Instead, the plaintiffs consistently seek to take advantage of the FCRA provisions which allow consumers to recover statutory damages of between $100 and $1,000 for each "willful" violation. Given the substantial volume of transactions at issue, the potential exposure on these claims could be enormous even though no actual injuries have been alleged.

Defendants have fought back on several fronts and have achieved some early successes, including defeating every class certification motion ruled on to date. While it is still early in the lives of the FACTA class actions, there is reason to believe the courts will see these claims for what they are – an attempt by the plaintiffs' bar to profit off of innocent mistakes that have hurt no one.

The FACTA Provisions. Section 1681c(g)(1) of the FCRA – enacted as part of FACTA – requires businesses to mask credit and debit card numbers and suppress the printing of card expiration dates on electronically printed consumer receipts:

> (1) In general. Except as otherwise provided in this subsection, no person that accepts credit cards for the transaction of business shall print more than the last 5 digits of the card number or the expiration date upon any receipt provided to the cardholder at the point of sale or transaction.

15 U.S.C. § 1681c(g)(1). Subsection (g)(2) provides that these requirements apply only to electronically printed

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receipts, and do not apply to transactions where the sole means of recording the account number is by handwriting or an imprint of the card. 15 U.S.C. § 1681c(g)(2).

Section 1681o of the FCRA allows a plaintiff to recover actual damages for negligent violations of Section 1681c(g). 15 U.S.C. § 1681o. Section 1681n of the FCRA provides for the right to recover statutory damages of $100 to $1,000 for each willful violation. 15 U.S.C. § 1681n. There is no cap on damages awarded under FACTA.

The FACTA Class Action Cases. Shortly after FACTA took effect on December 4, 2006, the plaintiffs' bar began filing class action cases in federal courts, initially in California against companies such as Victoria's Secret, The Limited, Charlotte Russe, Fuddruckers, Cost Plus, Barney's, Costco, Gymboree, and California Pizza Kitchen, alleging violations of Section 1681c(g). Since December, FACTA claims have been filed in at least a dozen states against large national retailers, small mom and pop stores, restaurants, and everything in between.

Although plaintiffs claim to be protecting consumers from identity theft and credit or debit card fraud, they do not allege that anyone has suffered any actual damages as a result of the alleged FACTA violations. In fact, some of the complaints expressly disavow any actual damages. Instead, the plaintiffs seek statutory damages of between $100 and $1,000 per violation under 15 U.S.C. § 1681n based on allegations that the defendants willfully violated FACTA.

Should a class be certified in one of these cases, the potential exposure to a defendant could be substantial. Assuming statutory damages of $100 per violation, every 100,000 receipts issued in violation of Section 1681c(g) creates a potential exposure of $10 million. If the maximum statutory damages of $1,000 per violation are awarded, then the potential exposure for these same 100,000 receipts is $100 million. The plaintiffs' class action bar no doubt hopes to use the threat of such catastrophic damages to entice defendants to settle.

What Constitutes Willfulness? Perhaps the most critical issue facing the parties to these FACTA class actions is whether plaintiffs can establish that a violation was willful, or at least present enough evidence to survive summary judgment on the issue.

Prior to June 4, 2007, there was a split among the Circuits as to what constituted "willful" conduct under the FCRA. Some circuits, including the Ninth Circuit, applied a more liberal definition of "willful" which required plaintiffs to prove (1) that the defendant intended to engage in the acts that violated the FCRA and (2) that the defendant either knew that its conduct violated the FCRA or acted "in reckless disregard" of the FACTA requirements. *Reynolds v. Hartford Fin. Servs. Group*, 435 F.3d 1081, 1097-99 (9th Cir. 2006). Other Circuits adopted a more stringent standard, allowing for a finding of willfulness only when the defendant actually *knew* that its intended conduct violated FACTA. *See, e.g., Wantz v. Experian Info. Solutions*, 386 F.3d 829, 834 (7th Cir. 2004)*; Phillips v. Grendahl*, 312 F.3d 357, 368 (8th Cir. 2002).

On June 4, 2007, however, the United States Supreme Court resolved this dispute in *Safeco v. Burr* and *GEICO v. Edo*, 127 S. Ct. 2201 (2007). These cases involved allegations that defendants violated the FCRA by failing to provide plaintiffs with notice of alleged adverse actions in setting insurance premiums based on adverse credit scores. Both the *Safeco* and *GEICO* district courts granted summary judgment in favor of the defendants and the Ninth Circuit reversed. In overturning the Ninth Circuit, the Supreme Court held that a "willful" violation under § 1681n extended to "violation[s] committed in reckless disregard of" the FCRA requirements. *Safeco*, No. 06-84, 127 S. Ct. at 2205.

Significantly, the Supreme Court held that recklessness consists of actions involving "an unjustifiably high risk of harm that is either known or so obvious that it should be known," and is to be measured objectively. *Id.* at 2215. The Court further explained that "[i]t is this high risk of harm, objectively assessed, that is the essence of recklessness at common law." *Id*. "Thus, a company subject to FCRA does not act in reckless disregard of it unless the action is not only a violation under a reasonable reading of the statute's terms, but shows that the company ran a risk of violating the law substantially greater than the risk associated with a reading that was merely careless." *Id*.

It is also significant that the Supreme Court ruled that the claims against Safeco failed as a matter of law based on the summary judgment record. *Id*. at 2216. This ruling confirms that, where the record supports it, FACTA cases can be resolved on summary judgment. That message apparently has not been lost on the trial courts. In the only ruling to date on the merits of plaintiffs' willfulness allegations under FACTA, Judge Klausner of the United States District Court for the Central District of California, granted Charlotte Russe's motion for summary judgment finding "no triable issue of fact as to the issue of willfulness." *Najarian v. Charlotte Russe, Inc.*, No. CV-07-501-RGK (CTx) (C.D. Cal. Aug. 16, 2007 Order), at 3.

Why Would Anyone Willfully Violate FACTA? Of course, this begs the question: Why would any business willfully violate FACTA? The potential exposure to a business that willfully violates FACTA ranges from substantial, in the best-case scenario, to catastrophic, in the worst-case scenario. At the same time, many FACTA plaintiffs allege that the cost for the defendants to become compliant was relatively low. Under those circumstances, it is hard to fathom why a rational business would, either knowingly or recklessly, incur such a risk when there is no financial upside – no benefit to be gained – by failing to comply with the FACTA requirements.

The FACTA class action complaints provide no answer to this question. The complaints do not allege any economic rationale for the allegedly "willful" violations, nor do they allege any particularized facts demonstrating that the defendants knew or even suspected they were violating FACTA. Instead, plaintiffs generally rely on cookie cutter allegations that defendants must have acted willfully because FACTA was enacted in 2003, and the credit card industry and others issued general warnings about the need to comply with FACTA, but the defendants failed to become compliant. While some plaintiffs allege that the defendants actually knew about FACTA, these allegations are typically made on information and belief with no explanation of the basis for that belief. Nor have plaintiffs made any attempt to address the efforts that defendants did make to comply with FACTA.

From the pleadings and motion papers filed to date, it appears that most of the defendants are alleged to have violated FACTA by failing to remove the expiration dates from customers' credit and debit card receipts. For some defendants, many of whom went to great efforts to comply with FACTA and other industry standards, it appears that the alleged violations were a result of an unintended technical or human error. In any case, plaintiffs ignore the complex sea of statutes, rules, and regulations – both government- and industry-imposed – that businesses must deal with in the area of data privacy and security. It is naïve to assume that the defendants could not possibly have overlooked the detailed requirements of FACTA such that their failure to comply, in and of itself, demonstrates willfulness.

The FACTA plaintiffs' sketchy allegations of willfulness are now being attacked by defendants on the grounds that plaintiffs have failed to allege "plausible" claims of willfulness as required by the United States Supreme Court's recent decision in *Bell Atlantic Co. v. Twombly*, 127 S. Ct. 1955 (2007).[1] Because *Bell Atlantic* was decided after the California cases were at issue, its application was not tested in the initial wave of FACTA cases. Defendants in some of the more recently filed cases, however, have filed motions to dismiss under *Bell Atlantic*. In what appears to be the first reported decision on this issue in the FACTA class actions, Judge Der-Yeghiayan of the Northern District of Illinois denied a defendant's motion to dismiss under *Bell Atlantic*. *Losello v. Leiblys, Inc.*, No. 07 C 2454, 2007 WL 2398474 (N.D. Ill. Aug. 22, 2007).

The Battle Over Class Certification. Perhaps the FACTA defendants' greatest success to date has come in their opposition to class certification. Because plaintiffs' claims only present a serious threat of exposure if plaintiffs can aggregate statutory damages for an entire class of consumers, losing on class certification is effectively a death knell to plaintiffs. But that is precisely what has been happening in California. To date, every

[1] *Bell Atlantic* involved a purported class action alleging a violation of Section 1 of the Sherman Act. The *Bell-Atlantic* plaintiffs' conspiracy allegations were limited to allegations of parallel conduct and conclusory allegations that the defendants conspired. The trial court dismissed the plaintiffs' complaint under Rule 12(b)(6) and the Second Circuit reversed. The Supreme Court, however, reinstated the trial court's dismissal order, finding the plaintiffs' allegations of parallel conduct – which does not violate the Sherman Act – were insufficient to state a claim. Rather, Rule 9 requires a plaintiff to allege facts from which a cognizable claim is "plausible." *Bell Atlantic*, 127 S. Ct. 1955.

judge who has ruled on class certification in the FACTA cases has denied certification.[2] Typically, these courts have relied on a host of factors, including: that the damages sought by plaintiffs "would be ruinous" to the defendants; the absence of any actual harm to plaintiffs; the resulting disproportionality between the damages sought and the harm alleged; the improbability, if not impossibility, that the printing of the additional information on customer receipts could result in identity theft or any other actual harm; the defendants' prompt correction of their alleged non-compliance; the ability of any consumer who has been actually harmed to bring an individual claim and collect attorneys' fees; and the potential for abuse by plaintiffs' attorneys. *See, e.g., Spikings v. Cost Plus, Inc.*, No. CV 06-8125, 2007 U.S. Dist. LEXIS 44214 (C.D. Cal. May 25, 2007 Order), at 3-6. The courts outside of California have not yet addressed the class certification issue in FACTA cases.

Plaintiffs in several cases have filed petitions for leave to appeal the California denials of class certification to the U.S. Court of Appeals for the Ninth Circuit.[3] The Ninth Circuit has not yet ruled on those petitions. In the meantime, at least one California trial court has stayed all proceedings pending a ruling by the Ninth Circuit. *See Arcilla v. Adidas Promotional Retail Operations, Inc.*, No. CV-07-211-GAF (SHx) (C.D. Cal. Aug. 15, 2007 Order).

Some plaintiffs have responded to the California class certification rulings by unilaterally amending their complaints, significantly reducing the size of the classes they purport to represent by limiting the class to customers of a single store or a small number of stores. Apparently, plaintiffs hope that by limiting the size of the class they can significantly reduce or eliminate the courts' concerns regarding the disproportionality of damages sought by plaintiffs when compared to plaintiffs' harm, or lack thereof. So far, however, these efforts have been unavailing. *See Evans v. U-Haul Co. of Cal.*, No. CV-07-2097-JFW (JCx) (C.D. Cal. Aug. 14, 2007 Order) (denying class certification).

Conclusion. While the FACTA class actions are far from over – indeed, new cases are being filed every week – it is fair to ask what precisely these cases have accomplished. As the courts have recognized, nobody claims to have been harmed by the FACTA defendants' alleged non-compliance. Moreover, plaintiffs have yet to establish willful conduct by the FACTA defendants. While it is true that defendants have corrected their respective problems in response to the lawsuits filed against them, there is no reason to believe that they would not have done so in response to a simple demand letter.

Nevertheless, these FACTA class actions continue to take up valuable judicial resources and to cost the defendants tens or hundreds of thousands of dollars in defense costs alone. This is precisely the type of abuse of the class action process over which the United States Supreme Court expressed concern in its recent decision in *Bell Atlantic* – the prospect that a vaguely worded and conclusory allegation in a putative class action case can, if allowed to proceed, cause significant harm even if plaintiffs do not ultimately prevail at trial. All parties, save perhaps the plaintiffs' class action bar, would be best served by the courts nipping this problem in the bud and disposing of the FACTA class actions early on.

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[2] *See Spikings v. Cost Plus, Inc.*, No. CV 06-8125, 2007 U.S. Dist. LEXIS 44214 (C.D. Cal. May 25, 2007 Order); *Najarian v. Charlotte Russe, Inc.*, No. CV 07-501-RGK (CTx.) (C.D. Cal. June 12, 2007 Order); *Najarian v. Avis Rent A Car Sys.*, No. 07-588, 2007 U.S. Dist. LEXIS 59932 (C.D. Cal. June 11, 2007 Order); *Soualian v. Int'l Coffee and Tea, LLC*, No. CV 07-502, 2007 U.S. Dist. LEXIS 44208 (C.D. Cal. June 11, 2007 Order); *Torossian v. Vitamin Shoppe Indus.*, No. CV 07-0523-ODW (SSx) (C.D. Cal. Aug. 9, 2007 Order); *Evans v. U-Haul Co. of Cal.*, CV 07-2097-JFW (JCx) (C.D. Cal. Aug. 15, 2007 Order); *Papazian v. Burberry Ltd.*, No. CV 07-1479-GPS (RZX) (C.D. Cal. Aug. 3, 2007 Order); *Lopez v. KB Toys Retail, Inc.*, No. CV 07-114-JWF (CWx) (C.D. Cal. July 18, 2007 Order), all pending in the United States District Court for the Central District of California.

[3] *See Spikings v. Cost Plus, Inc.*, No. CV 06-8125-JFW (AJWx) (C.D. Cal. Petition for Permission to Appeal); *Torossian v. Vitamin Shoppe Indus.*, No. CV 07-0523-ODW (SSx) (C.D. Cal. Petition for Permission to Appeal); *Najarian v. Charlotte Russe, Inc.*, No. CV 07-501-RGK (CTx.) (C.D. Cal. Appeal Petition); *Soualian v. Int'l Coffee and Tea, LLC*, No. CV 07-502- (C.D. Cal. Petition for Permission to Appeal).