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A Closer Look At Barnes & Noble Data Breach Ruling

By **Joshua Jessen and Ashley Van Zelst** (May 7, 2018, 1:12 PM EDT)

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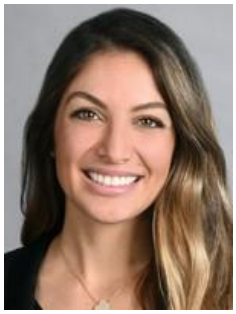

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Last month, a three-judge panel of the Seventh Circuit issued an opinion in Dieffenbach v. Barnes & Noble Inc.[1] — a proposed data breach class action — that appeared to suggest that a plaintiff who has adequately pled an injury-in-fact for purposes of Article III standing has per se pled damages sufficient to withstand a motion to dismiss for failure to state a claim upon which relief may be granted under Federal Rule of Civil Procedure 12(b)(6). A closer inspection of the opinion, however, reveals that the holding was not so broad, and that there will continue to be circumstances in data breach cases where a plaintiff's complaint may be able to survive an Article III standing challenge but will still be dismissed for failure to state a claim due to the absence of cognizable damages. One of those circumstances is the increasingly common situation where a plaintiff has alleged a future risk of identity theft but has not yet suffered any actual harm.

The Seventh Circuit's opinion in Dieffenbach is also significant because it suggests that, while more data breach lawsuits may be able to advance beyond the pleadings stage, these lawsuits face significant substantive and class certification challenges as the cases progress. This is a point also underscored by the Ninth Circuit's recent decision in In re Zappos.com Inc. Customer Data Security Breach Litigation, another proposed data breach class action where the court held that plaintiffs had adequately alleged Article III injury-in-fact based on the substantial risk of future identity theft.[2]

In Dieffenbach, customers sued Barnes & Noble after thieves compromised some of the machines (PIN pads) used to verify payment information in Barnes & Noble stores. The thieves "acquired details such as customers' names, card numbers and expiration dates, and PINs."[3] The plaintiffs alleged that, as a result of this theft, they had suffered various harms, including the "temporary [loss of] the use of their funds while waiting for banks to reverse unauthorized charges to their accounts" and "the value of their time devoted to acquiring new account numbers and notifying businesses of these changes."[4] They also alleged that they "spent money on credit-monitoring services to protect their financial interests."[5] The plaintiffs asserted various state law claims against Barnes & Noble under California and Illinois law.

Initially, the Illinois federal district court held that the plaintiffs had not alleged a concrete injury-in-fact and thus did not have constitutional standing to bring their claims in federal court.[6] In a subsequent opinion, however, the district court (acting through a different judge) reassessed the standing issue in

light of other decisions by the Seventh Circuit holding that consumers who have their credit card data stolen may have constitutional standing even if no actual harm has yet to occur, where there is a substantial risk of future harm and plaintiffs have incurred costs to mitigate or avoid that future harm.[7] Specifically, the district court looked to Remijas v. Neiman Marcus Group LLC, another data breach lawsuit in which the Seventh Circuit held that the following alleged harms were each sufficient to plead injury-in-fact for Article III standing: unreimbursed fraudulent charges, the fact that identity theft may occur in the future, and the fact that plaintiffs had lost time and money protecting themselves against future identity theft and fraudulent charges.[8] In light of this (and other similar) holding(s), the district court reversed its earlier decision and found that the complaint sufficiently alleged injury for Article III standing purposes.[9] In the same opinion, though, the court dismissed the complaint for failure to state a claim under Federal Rule of Civil Procedure 12(b)(6) on the ground that plaintiffs had failed to adequately plead damages under their asserted state law claims.[10]

On appeal, the Seventh Circuit reversed the dismissal, holding that the allegations that plaintiffs had made to establish Article III standing were also sufficient to state a claim under Rule 12(b)(6).[11] The district court's decision, the Seventh Circuit noted, "seems to use a new label for an old error."[12] The court explained:

> To say that the plaintiffs have standing is to say that they have alleged injury in fact, and if they have suffered an injury then damages are available (if Barnes & Noble violated the statutes on which the claims rest). ... The[] injuries [alleged by the plaintiffs] can justify money damages, just as they support standing.[13]

The opinion, at first blush, appears to suggest that data breach plaintiffs who allege Article III injury-in-fact have, by definition, sufficiently pled cognizable damages under their substantive state law claims for purposes of surviving a motion to dismiss for failure to state a claim. But a more careful reading of the opinion reveals that it is largely consistent with existing case law and should apply only in situations where data breach plaintiffs allege an actual, present loss — such as paying money for credit-monitoring services in response to theft of credit card information — that could satisfy both Article III's injury-in-fact requirement and the damages element of a specific legal claim.

Indeed, while the court stated that data breach plaintiffs generally need not plead details regarding injury under the requirements of Federal Rule of Civil Procedure 8, it explained that "a district court could grant judgment on the pleadings, see Federal Rule of Civil Procedure 12(c), if none of the plaintiffs' injuries is compensable, as a matter of law, under the statutes on which they rely."[14] The court also noted that even if injury is sufficiently alleged, damages are available only if "the statutes on which the claims rest" — many of which may have damages as an element of the claim — are "violated."[15]

This holding arguably squares with existing case law, which generally has drawn a distinction between injuries sufficient to open the federal courthouse doors (Article III injury) and injuries sufficient to plead damages under substantive legal claims. The Ninth Circuit's dual decisions in the 2010 case of Krottner v. Starbucks Corp. are instructive.[16] In Krottner, a laptop containing the unencrypted personal data — including names, addresses, and Social Security numbers — of 97,000 Starbucks employees was stolen, and some of the employees sued Starbucks for negligence and breach of implied contract under state law.[17] In a published opinion, the Ninth Circuit held that the plaintiffs' allegations of an increased risk of future identity theft stemming from the wrongful acquisition of this sensitive data — even without actual identity theft or related loss — were sufficient to allege injury-in-fact for purposes of Article III standing.[18] But in a separate (unpublished) opinion, the court held that those same alleged injuries — the future risk of harm without any current loss — were insufficient to allege the element of damages

required for their claims, such that the district court properly dismissed the claims under Rule 12(b)(6).[19] Had the facts alleged in Dieffenbach been the same as those alleged in Krottner, the outcome should have been the same.

Furthermore, while the Dieffenbach court allowed the complaint against Barnes & Noble to proceed beyond the pleadings stage, the court suggested that the plaintiffs had many obstacles ahead. For example, the court noted that for plaintiffs who alleged they paid for credit-monitoring services as a result of the breach "[t]o get damages," they "must show that a culpable data breach caused the monthly payments."[20] More globally, the court observed that:

> Barnes & Noble was itself a victim. Its reputation took a hit, it had to replace the compromised equipment plus other terminals that had been shown to be vulnerable, and it lost business. None of the state laws expressly makes merchants liable for failure to crime-proof their point-of-sale systems. Plaintiffs may have a difficult task showing an entitlement to collect damages from a fellow victim of the data thieves. It is also far from clear that this suit should be certified as a class action; both the state laws and the potential damages are disparate.[21]

The Ninth Circuit made similar observations in the above-referenced Zappos case.[22] In Zappos, the court held that Krottner remains good law in the Ninth Circuit, and that customers whose credit card information had been stolen, but not yet used by the hackers, had pled Article III standing to sue the retailer from which the information had been stolen based on the tangible, future risk of harm related to the data breach.[23] But the court also recognized that "[o]f course, as litigation proceeds beyond the pleadings stage, the Complaint's allegations will not sustain Plaintiffs' standing on their own."[24] And the court also noted while an argument "[t]hat hackers might have stolen Plaintiffs' PII in unrelated breaches, and that Plaintiffs might suffer identity theft or fraud caused by the data stolen in those other breaches (rather than the data stolen from Zappos)" may not be sufficient grounds for a complaint to be dismissed on the pleadings, such an argument is relevant to "the merits of causation and damages" — both of which also present significant hurdles to class certification.[25]

In sum, while the Seventh Circuit's holding in Dieffenbach may mean that more putative data breach class actions advance beyond the pleadings stage where plaintiffs have sufficiently alleged Article III injury, it should not be read for the proposition that pleading Article III injury is the equivalent of pleading damages under substantive state law claims. This is especially true where the only alleged harm is the future risk of identity theft or fraud. Claims alleging only this type of harm should still be subject to dismissal pursuant to Rule 12(b)(6). Additionally, the opinion provides defendants with additional ammunition to defeat those lawsuits that do extend past the pleading stage — either on the merits or via a successful opposition to class certification.

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[1] 887 F.3d 826 (7th Cir. 2018).

[2] No. 16-16860, 2018 WL 1883212 (9th Cir. Apr. 20, 2018).

[3] Dieffenbach, 887 F.3d at 826.

[4] Id.

[5] Id.

[6] In re Barnes & Noble Pin Pad Litig., No. 12-CV-8617, 2013 WL 4759588, at *2 (N.D. Ill. Sept. 3, 2013).

[7] In re Barnes & Noble Pin Pad Litig., No. 12-CV-8617, 2016 WL 5720370, at *3 (N.D. Ill. Oct. 3, 2016).

[8] Remijas v. Neiman Marcus Grp., LLC, 794 F.3d 688, 690-92 (7th Cir. 2015).

[9] In re Barnes & Noble, 2016 WL 5720370, at *9.

[10] Id.

[11] Id. at *4-6.

[12] Dieffenbach, 887 F.3d at 826.

[13] Id.

[14] Id.

[15] Id.

[16] 628 F.3d 1139 (9th Cir. 2010).

[17] Id. at 1142-43.

[18] Id.

[19] Krottner v. Starbucks Corp., 406 F. App'x 129, 131-32 (9th Cir. 2010) ("injury-in-fact for purposes of Article III standing does not establish that they adequately pled damages for purposes of their state-law claims").

[20] Dieffenbach, 887 F.3d at 826 (emphasis added).

[21] Id.

[22] In re Zappos.com, 2018 WL 1883212.

[23] Id. at *2, 6.

[24] Id. at *6 n.12.

[25] Id. at *7.