

# StayCurrent

A Client Alert from Paul Hastings

## A Matter of FACTA (Part II): Recent Developments Favor Defendants in Defeating Class Actions Alleging Willful Violations

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### INTRODUCTION

Class action litigation relating to the Fair and Accurate Credit Transactions Act (“FACTA”) has become something of a national phenomenon. Beginning in December 2006, plaintiffs’ attorneys began filing lawsuits in federal courts in California against retailers, restaurants and exhibitors alleging willful violations of FACTA based largely on the appearance of an expiration date on an electronically-printed credit card receipt provided to consumers. The impetus for these lawsuits is the availability of statutory penalties of between \$100 and \$1,000 per consumer for each willful violation, and the fact that the effective date for compliance for all credit card machines was December 4, 2006. *See* 15 U.S.C. § 1681n. In total, there have been approximately 130 lawsuits filed in California, and approximately 75 others in federal courts in Pennsylvania, Illinois, New Jersey, Nevada, Maryland, Florida and Kansas.

On April 11, 2007, Paul Hastings issued its Client Alert addressing the recent wave of class actions based on alleged violations of FACTA. At that time, plaintiff’s counsel were beaming over the unanimous denials of motions to dismiss challenging the legal sufficiency of the pleadings. Recent developments in the FACTA cases, however, have resulted in a sea change in FACTA litigation favoring defendants that have been wrongfully subjected to expensive litigation over the appearance of an innocuous expiration date on a credit card receipt. Specifically, courts in California have uniformly denied class certification in cases alleging FACTA violations based on the appearance of expiration dates on credit card receipts. Courts in other jurisdictions have yet to rule on class certification motions, but such rulings are expected in August and September. If these rulings follow those in California, coupled with the Supreme

Court’s recent holding that a violation can be considered willful only where there exists “an unjustifiably high risk of harm that is either known or so obvious that it should be known,” the likelihood that the FACTA cases will result in the windfall plaintiffs anticipated has been unquestionably downgraded.

On a parallel track, the lawyers and lobbyists of Paul Hastings are leading the efforts to obtain a legislative remedy that will insulate defendants from liability for statutory damages under FACTA where the only purported violation is the appearance of an expiration date on the credit card receipt. Preliminary meetings with key congressional staff have indicated an appreciation of the need for narrowly targeted FACTA reform to halt these abusive lawsuits. Formation of a diverse and broad coalition of defendant companies supporting a legislative remedy will make FACTA legislative reform a viable option.

### BACKGROUND OF FACTA

In 2003, Congress passed, and the President signed, FACTA requiring the truncation of credit card information. *See* 15 U.S.C. § 1681c. (FACTA added sections to the existing Fair Credit Reporting Act (“FCRA”).) FACTA provides: “no person that accepts credit cards or debit 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 the sale or transaction.” 15 U.S.C. § 1681c. [Emphasis omitted.] The purpose of FACTA is to “prevent criminals from obtaining easy access to such key information.”<sup>1</sup> Damages for violating the statute are two-tiered, based on whether the violation was “willful” or “negligent.” Where a violation is willful, the statute provides for statutory penalties of between

\$100 and \$1,000 per transaction, and also provides for the recovery of attorney's fees, costs and punitive damages. See 15 U.S.C. § 1681n. A negligent violation requires proof of actual damages, but a successful plaintiff may also recover attorney's fees and costs. See 15 U.S.C. § 1681o.

The vast majority of the lawsuits contain only boilerplate allegations that Defendants "willfully" violated FACTA by printing more than the last five digits of the credit card numbers and/or the expiration date on the receipts. Plaintiffs have disclaimed any actual damages in those cases, and have based their class definitions only on the recovery of statutory damages. At the time that nearly all of the currently-pending FACTA lawsuits were filed, two critical questions that created uncertainty for both plaintiffs and defendants remained unanswered.

The first question was what definition of "willfulness" the United States Supreme Court would adopt in *Safeco v. Burr*, 127 S. Ct. 2201 (2007). The Ninth Circuit adopted a "recklessness standard." Other circuits determined that willfulness required actual knowledge of the statute and a purposeful violation. The Supreme Court's opinion was highly anticipated.

The second question was whether the cases could be certified as class actions. Because the companies sued transact a great deal of their business by credit card transactions, the potential amount of statutory damages is extraordinary, and likely would cripple some of them if awarded. As a result, defendants believed that courts would be reluctant to certify these cases as class actions. Plaintiffs' lawyers knew their only ability to "cash in" on this statute turned on whether the courts would permit class actions.

## RECENT DEVELOPMENTS IN FACTA LITIGATION

### *Supreme Court Adopts "Reckless Disregard" Standard for Willful Violations*

On June 4, 2007, the United States Supreme Court issued its opinion in *Safeco Ins. Co. of Am. v. Burr*, 127 S. Ct. 2201 (2007) (which was consolidated with *GEICO Gen. Ins. v. Edo*) interpreting the "willfulness" requirement for statutory damages under Section 1681n(a) of the FCRA. The Court did not address FACTA or its truncation requirements, but liability under FACTA (which consists

of amendments to FCRA) will certainly be affected by the decision.

There, the Court held that "willful" includes a violation committed "recklessly." Nevertheless, the Court noted that "reckless" still requires an action entailing "an unjustifiably high risk of harm that is either known or so obvious that it should be known." *Id.* at 2215. Thus, "a company subject to the 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.*

In *Safeco*, the Court was faced with determining whether Safeco "willfully" violated the FCRA's notice obligations to consumers regarding sending a "no adverse action" letter based on consumer reports. The Supreme Court held that Safeco's interpretation of the statute was not reckless because its reading of the statute at issue was not unreasonable, even though it was incorrect. The Court noted that there were no published opinions or other guidelines interpreting the particular statute at issue. Although the Court did adopt the "reckless disregard" standard, the Court found that "[t]he negligence/recklessness line need not be pinpointed here." *Id.* at 2204. In reaching this finding, the Court looked toward common law: "The common law has generally understood 'recklessness' in the civil liability sphere as conduct violating an objective standard: action entailing 'an unjustifiably high risk of harm that is either known or so obvious that it should be known.'" *Id.* [Emphasis added.] The Court found that "there being no indication that Congress had something different in mind, there is no reason to deviate from the common law understanding in applying the statute." *Id.*

In most of the FACTA cases, the defendants have taken the position that they were unaware of the requirement to remove the expiration date from the receipts. In denying every motion to dismiss brought by defendants in the Central District of California, the courts interpreted FACTA's truncation requirements to prohibit the expiration date from appearing on the receipt. The *Safeco* decision appears to make this determination far less consequential because no plaintiff has provided any evidence that, where the credit card numbers have been properly truncated, the appearance of an expiration date subjects an individual to "an unjustifiably high risk of

harm that is either known or so obvious that it should be known.” *Id.* at 2215. Nevertheless, further litigation exploring the definition of willful in the specific context of FACTA remains a possibility.

### **Courts Thus Far Have Uniformly Denied Class Treatment in FACTA Expiration Date Cases**

Since the *Safeco* decision, courts in the Central District of California have issued rulings on five motions for class certification in FACTA matters. In each case, the court denied class certification on the ground that the class action mechanism is not “superior to other available methods for the fair and efficient adjudication of the controversy,” as required by Rule 23(b) of the Federal Rules of Civil Procedure.<sup>2</sup> See, e.g., *Spikings v. Cost Plus, Inc.*, No. CV 06-8125-JFW (AJWx), 2007 U.S. Dist. LEXIS 44214, at \*6 (C.D. Cal. May 25, 2007). For example, the *Spikings* Court found, “if a class is certified and Plaintiff prevails, even the minimum statutory damages would be ruinous to Defendant,” resulting in lost jobs and forcing the Defendant into bankruptcy or closure despite plaintiff’s inability to show that anyone suffered any actual harm. *Id.* at \*12 (discussing that the minimum award of statutory damages of \$100 per transaction would result in \$340 million in damages, which would put the Defendant out of business).

Additionally, on June 11 and 12, 2007, Judge Gary Klausner of the Central District of California issued three separate decisions denying class certification in FACTA cases. See *Soualian v. Int’l Coffee and Tea LLC*, No. CV-00502-RGK (JCx), 2007 U.S. Dist. LEXIS 44208 (C.D. Cal. June 11, 2007); *Najarian v. Charlotte Russe, Inc.*, No. CV-00501-RGK (CTx) (C.D. Cal. June 12, 2007); *Najarian v. Avis Rent A Car Sys., Inc.*, No. CV 07-00588-RGK (Ex) (C.D. Cal. June 11, 2007). The defendants in these cases represented a cross-section of industries: International Coffee and Tea LLC – restaurants; Charlotte Russe, Inc. – retailer; and Avis Rent A Car – rental car industry. Plaintiffs in *Cost Plus*, *International Coffee and Tea*, and *Charlotte Russe* have sought permission from the Ninth Circuit to appeal these rulings. At the time of this Client Alert, the Ninth Circuit has yet to decide whether to hear the appeals.

In reaching these holdings, the courts discussed the factors to determine whether a class is maintainable under Rule 23(b)(3), which requires that “questions of law or fact that are common to the members of the class

predominate over any questions affecting only individual members” and that “a class action is superior to other available methods for fair and efficient adjudication of the controversy” Fed. R. Civ. P. 23(b)(3) [Emphasis added].

The analysis under Rule 23(b)(3) requires a weighing of factors including: “(A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; [and] (D) the difficulties likely to be encountered in the management of a class action.” Fed. R. Civ. P. 23(b)(3). In applying this analysis, the *Avis Rent A Car* Court found that individualized issues predominate because each class member must prove both that he or she obtained a “receipt” under the meaning of the statute and that he or she was acting as a “customer;” “the defendant’s liability ‘would be enormous and completely out of proportion to any harm suffered by the plaintiff.’” *Avis* Order at 4.

In addition, the *Avis* Court, agreeing with the decision in *Cost Plus*, held that “class treatment is not the superior method of adjudication because Avis’ liability “would be enormous and completely out of proportion to any harm suffered by the plaintiff.” *Avis* Order at 4 (citing *Kline v. Coldwell Banker & Co.*, 508 F. 2d 226 (9th Cir. 1974)). The Court noted that a finding of willful violation would create liability for Avis of \$1.66 billion in the absence of actual harm.

In *International Coffee and Tea*, the Court denied certification under Rule 23(b) because “[g]iven the disproportionate consequences to Defendant’s business and the lack of any actual harm suffered by members of the potential class, the Court finds that Plaintiff fails to meet the superiority requirements.” *Int’l Coffee and Tea*, 2007 U.S. Dist. LEXIS 44208 at \*10. Similarly, with respect to disproportionate consequences, the *Charlotte Russe* Court also denied certification, finding that class treatment would lead to a disproportionate damage award in relation to the harm actually suffered by the class. Specifically, the Court discussed that, “if class certification is granted and the Class is able to prove that Defendant committed a ‘willful’ violation of FACTA, statutory damages could total anywhere between \$220 million to \$2.2 billion. . . . [T]he total stockholders’ equity

in the company was valued at \$206 million. Therefore, an award of even the minimum statutory damages in this case would destroy Defendant's business." *Charlotte Russe* at Order at 3.

In each of the four decisions, the court relied on the declaration of defendants' expert witness who testified that the appearance of an expiration date without the card number cannot possibly cause any actual injury. In addition, all four decisions made particular note of the fact that the defendants promptly began the process of removing the expiration date after learning of non-compliance. *See, e.g. Cost Plus*, U.S. Dist. LEXIS 44214 at \*14 ("Moreover, as soon as becoming aware that having the expiration date on credit card and debit card receipts may have been a technical violation of FACTA, Defendant promptly began the process of removing the expiration date from these receipts, and had removed the expiration [date] from all its stores' credit card and debit card receipts within one month. Defendant's immediate action to comply with FACTA's requirements once becoming aware of Plaintiff's Complaint also supports denial of class certification in this case."); *Avis Rent A Car* (discussing that Defendants' compliance efforts reduce benefits of class treatment and finding that "Defendants' immediate action to comply with Section 1681 upon becoming aware of violations also supports denial of class certification.").

Finally, the courts noted that denial of the class action would not prevent anyone who actually suffered any injury to bring an individual claim for actual damages. "Therefore, some of the concerns that might favor certification in other consumer protection schemes that do not provide for statutory damages or attorney's fees are not present here." *Charlotte Russe* at Order at 4. The courts also discussed that class certification in these

instances would create the potential for attorney abuse of class actions.

### **Lobbying Efforts to Reform FACTA**

Paul Hastings lawyers are also making progress on the legislative front as they continue to push for a congressional solution to these lawsuits. While the recent court decisions denying class certification are positive, plaintiffs are appealing the decisions, and consequently forcing defendants to incur additional legal defense costs. Our attorneys are leading the lobbying effort to advance a remedy that would effectively insulate defendants from statutory damages. We have already initiated preliminary meetings with key congressional staff who have indicated an understanding of the problem and some sympathy for amending the statute to eliminate retroactively liability for statutory damages for those companies that truncated the credit card numbers but failed to delete the expiration dates from credit card receipts. The judicial decisions denying class certification cited in this Client Alert also will be useful in the legislative process, buttressing arguments that it is not sound public policy to expose companies to grossly excessive and potentially bankrupting statutory damages absent actual harm to consumers. Despite the substantive strength of arguments in favor of targeted FACTA reform, there remains a political imperative to form a coalition of interested parties of diverse geographic and industry backgrounds to generate the requisite support essential to moving legislation. This legislative effort has moved past the initial stages and can be expected to progress in tandem with parallel efforts in court. The expansion of the coalition urging FACTA reform is critical, however, to both the likelihood of a successful legislative effort and the speed with which it can be achieved.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings lawyers:

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<sup>1</sup> Senate report No. 108-166, entitled "Amending Fair Credit Reporting Act," to accompany S. 1753 dated October 17, 2003, prepared by the Senate Committee on Banking, Housing and Urban Affairs.

<sup>2</sup> In the case *Parseghian v. Bally North America, Inc.*, Case No. 07-00347-GW (C.D. Cal.), the court denied class certification, without prejudice to plaintiff's ability to file a later motion after discovery.