A Matter of FACTA: Part III – Legal and Legislative Crossroads

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INTRODUCTION

Class action litigation relating to the Fair and Accurate Credit Transactions Act ("FACTA") has evolved into a nationwide phenomenon, forcing businesses large and small across the country to defend themselves from lawsuits that disclaim any actual injury on the part of the plaintiff and the purported class. Beginning in December 2006, plaintiffs’ attorneys began filing lawsuits in federal courts in California against retailers, restaurants and exhibitors alleging willful violations of FACTA 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 first Client Alert addressing the recent wave of class actions based on alleged violations of FACTA. At that time, plaintiffs’ counsel were beaming over the unanimous denials of motions to dismiss challenging the legal sufficiency of the pleadings. On August 6, 2007, Paul Hastings issued a second Client Alert on FACTA, noting that recent developments had 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, federal courts in California had uniformly denied class certification in cases alleging FACTA violations based on the appearance of expiration dates on credit card receipts.

While the tide has not again shifted, recent legal rulings have not all been favorable to defendants. The Court in Reynoso v. South County Concepts, Inc., No. SACV 07-373-JVS (RCx), 2007 WL 4592119 (C.D. Cal. Oct. 15, 2007) was the first court to break from the pack in California to grant class certification. In the first FACTA cases outside California to rule on class certification, two courts in the Northern District of Illinois issued orders to certify a class. See Halperin v. Inter-Park, Inc., No. 07 C 2161, 2007 WL 4219419 (N.D. Ill. Nov. 29, 2007) and Troy v. The Red Lantern Inn, Inc., No. 07 C 2418, 2007 WL 4293014 (N.D. Ill. Dec. 4, 2007). As the vast majority of FACTA cases were filed in district courts throughout California, the most significant development may be the Ninth Circuit’s upcoming ruling on the district court’s denial of class certification in Soualian v. International Coffee and Tea LLC, No. CV-00502-RGK, 2007 U.S. Dist. LEXIS 44208 (C.D. Cal. June 11, 2007) (JCx). A ruling is expected in Spring 2008.

On a parallel track, the lawyers and lobbyists of Paul Hastings are leading the efforts to obtain a legislative remedy to eliminate the potential tremendous liability arising out of these strike suits. On October 30, 2007, Paul Hastings and its team successfully secured the introduction of H.R. 4008, the Credit and Debit Card Receipt Clarification Act. This legislation, which was introduced with bipartisan support by Congressmen Tim Mahoney (FL), Spencer Bachus (AL), Nick Lampson (TX), Paul Hodes (NH), Barron Hill (IN), Melissa Bean (IL), Jim Matheson (UT), John Barrow (GA), Ron Klein (FL) and Michele Bachmann (MN), would retroactively 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. Formation of a diverse and broad coalition of defendant companies supporting a legislative remedy will make this 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(g)(1) (emphasis omitted). The purpose of FACTA is to “prevent criminals from obtaining easy access to such key information.”1 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 attorneys’ 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 attorneys’ 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 Insurance Co. of America v. Burr, 127 S. Ct. 2201, 2216 (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 (which was consolidated with GEICO General Insurance 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.” Safeco, 127 S. Ct. at 2216. 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 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. Id. at 2216. 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 2215. 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. at 2204 (emphasis added) (quoting Farmer v.
Brennan, 511 U.S. 825, 836 (1994)). The Court found that “[t]here 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.

The Vast Majority of Courts Thus Far Have Denied Class Treatment in FACTA Expiration Date Cases

Decisions Denying Class Certification

Since the Safeco decision, courts in the Central District of California have issued a large number of rulings on motions for class certification in FACTA matters. In all but one of those cases, 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. See, e.g., Spikings v. Cost Plus, Inc., No. CV 06-8125-JFW (AJWx), 2007 U.S. Dist. LEXIS 44214, at *7 (C.D. Cal. May 25, 2007). For example, the Cost Plus 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).


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 fairly and efficiently adjudicating 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 class members’ interests in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already begun by or against class members; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; and (D) the likely difficulties in managing 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, at * 11-12 (Kline v. Coldwell Banker & Co., 508 F.2d 226 (9th Cir. 1974).
In addition, the Avis court, agreeing with the decision in Cost Plus, held that “class treatment is not a superior method of adjudication” because Avis’s liability “would be enormous and completely out of proportion to any harm suffered by the plaintiff.” Avis at *12 (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 *11. 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 Order, at * 7-8 (citation omitted).

In many of these 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, 2007 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, at *15 (noting 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 Order, at *10; see also Order in Love’s Travel Stops, No. 507 CV 90 (C.D. Cal. Dec. 18, 2007 at 4:2-5:6) (noting that the availability of attorneys’ fees allows individuals to pursue claims with no economic hindrance).

The courts also discussed that class certification in these instances would create the potential for attorney abuse of class actions. The courts specifically noted that the same counsel has filed a large number of FACTA cases, and in each one seeks to certify a class. See, e.g., Love’s Travel Stops, Order at 8-9. Thus, this potential for abuse provides the courts with an additional ground to deny class certification.

**Decisions Granting Class Certification**

As mentioned above, United States District Judge James Selna broke with all of the other courts in the district courts to certify a class action under FACTA in Reynoso v. South County Concepts, Inc., No. SACV 07-373-JVS (R CX), 2007 WL 4592119 (C.D. Cal. Oct. 15, 2007). In doing so, Judge Selna disagreed with other courts and rejected defendant’s argument that class treatment is not the superior method of adjudicating FACTA disputes. The court ruled that the constitutional question of “annihilating damages” which precipitated denial in other cases is better addressed during the damage phase after a class is already certified. The court also held that class action is the superior method of adjudicating FACTA lawsuits because the court is not convinced that the minimal amount of statutory damages, between $100 and $1,000 per customer, will result in enforcement comparable to a class action. South County Concepts, 2007 WL 4592119, at *4.

The first courts outside of California to rule on class
certification granted class certification based on rationale similar to the court in South County Concepts. In Halperin v. Inter-Park, Inc., Case No. 07 C 2161, 2007 WL 4219419 (N.D. Ill. Nov. 29, 2007) and Troy v. The Red Lantern Inn, Inc. No. 07 C 2418, 2007 WL 4293014 (N.D. Ill. Dec. 4, 2007), two courts in the Northern District of Illinois granted class certification. Relying on the same authority in the Seventh Circuit that the court in South County Concepts found persuasive, the court in Inter-Park noted:

The reason that damages can be substantial, however, does not lie in an “abuse” of Rule 23; it lies in the legislative decision to authorize awards. . . . The district judge sought to curtail the aggregate damages for violations he deemed trivial. Yet it is not appropriate to use procedural devices to undermine laws of which a judge disapproves. Maybe suits such as this will lead Congress to amend the [FCRA]; maybe not. While a statute remains on the books, however, it must be enforced rather than subverted. . . . Reducing recoveries by forcing everyone to litigate independently – so that constitutional bounds are not tested, because the statute cannot be enforced by more than a hand-ful of victims – has little to recommend it.

Halperin, 2007 WL 4219419, at *4 (citing Murray v. GMAC Mortgage Corp., 434 F.3d 948, 953-54 (7th Cir. 2006); see also Troy, 2007 WL 4293014, at *4 (citing Murray on superiority analysis).

One reason that the Illinois courts may have taken a different view from nearly every California court is that Illinois courts have not faced the same onslaught of FACTA class actions, and therefore have not appreciated that the cases are driven by attorneys, rather than by consumers seeking to advocate their rights. Nevertheless, the current status of litigation has created a great deal of uncertainty in FACTA litigation. This uncertainty opens the door to creative solutions which Paul Hastings has developed and implemented.

**Lobbying Efforts to Reform FACTA**

With litigation outcomes of FACTA cases uncertain, and new class actions being filed around the country, Paul Hastings lawyers are leading the efforts to push for a congressional solution to these lawsuits. While it initially appeared that courts were content to deny the class certification, decisions in the Northern District of Illinois and the recent decision by the District Court in California shows that it is possible for plaintiffs to successfully obtain class certification for these lawsuits.

Working with key members of Congress and their staff, the lawyers of Paul Hastings were successfully able to secure the introduction of H.R. 4008, the Credit and Debit Card Receipt Clarification Act. This legislation, which was introduced by Congressman Tim Mahoney, a newly elected Democratic member from Florida, would retroactively insulate those defendants who properly truncated the account number but failed to redact the expiration date from their receipts. Testament to the potential for a broad base of bipartisan support for this legislation can be seen in the fact that Mr. Mahoney was joined by the top Republican on the Financial Services Committee, Congressman Spencer Bachus of Alabama, in introducing this legislation. Additionally, eight other members of Congress, including Nick Lampson (D-TX), Paul Hodes (D-NH), Barron Hill (D-IN), Michele Bachmann (R-MN), Ron Klein (D-FL), Melissa Bean (D-IL), John Barrow (D-GA) and Jim Matheson (D-UT) joined in introducing the legislation.

While the introduction of the legislation is a significant milestone, much work remains before this bill can be enacted into law, including leveraging the natural constituencies of the companies that have been sued to provide the grassroots political support necessary for expedient consideration. The judicial decisions denying class certification cited in this Client Alert will also 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. The goal of this legislative effort is to secure enactment of the legislation before the Court of Appeals for the Ninth Circuit hands down its decision in International Coffee and Tea. 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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1 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.

2 In a number of cases, courts denied class certification, without prejudice to plaintiff’s ability to file a later motion after discovery. See Parseghian v. Bally N. Am., Inc., No. 07-00347-GW (C.D. Cal., Minute Order dated June 11, 2007). In addition, courts have stayed many cases at the request of the parties pending the Ninth Circuit’s determination of the propriety of class certification in the International Coffee and Tea case.