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ARE OFFERS OF FREE CREDIT MONITORING ABOUT TO BECOME MANDATORY IN DATA BREACH INCIDENTS?

By Sam Lunier

Although not legally required to do so, businesses that experience a data breach often provide free credit monitoring or identity theft prevention services to affected consumers. Offering these services can assist potentially affected consumers, help to rebuild a business's relationship with its customers, and may mitigate potential damage to consumers caused by misuse of their personal information. But at the end of the day, it is generally the business's decision whether to incur the costs of these services on top of other breach-related costs. That discretion may be about to disappear. Recent high-profile data breaches have prompted legislators at both the state and federal levels to introduce legislation that would impose a variety of new requirements in the event of a breach. Although these new laws differ in many respects, one emerging trend is the codification of a requirement that businesses offer free credit monitoring or identity theft prevention services to affected consumers.

At the federal level, such a requirement is one of the key features of the Data Security and Breach Notification Act of 2014, S. 1976, introduced in the Senate

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on January 30, 2014. This bill would, among other things, require businesses that suffer a data breach to provide affected consumers in many circumstances with a free credit report upon request, and to continue to provide free credit reports on a quarterly basis for two years thereafter. The Senate has yet to take any action concerning this bill.

In addition, several states have introduced legislation echoing the Senate bill. For example, on February 10, 2014, bill NJ A2480 was introduced in the New Jersey Assembly. Similar to the Senate bill, NJ A2480 would impose on any business required to provide notice of a data breach incident an obligation to pay for affected customers to receive a monthly credit report for at least a year. Customers would have a six-month window following notification of the breach in which to request these free credit reports. NJ A2480 is currently under consideration by the New Jersey Assembly Consumer Affairs Committee.

Shortly after the New Jersey bill was introduced, similar legislation was introduced in both Rhode Island and Minnesota to modify those states' respective breach notification laws. Unlike the Senate and New Jersey bills, however, both the Rhode Island bill (2014 H7519) and the Minnesota bill (H.F. 2253) would require businesses to provide credit monitoring services, rather than simply provide free credit reports. More specifically, both bills would mandate that businesses required to provide notice of a data breach also provide one year of free credit monitoring to individuals whose personal information was taken, or reasonably believed to have been taken, as part of the breach. H.F. 2253 was referred to the Minnesota House of Representatives Commerce and Consumer Protection Finance and Policy Committee on February 25, 2014. On March 4, 2014, the Rhode Island House Judiciary Committee recommended that 2014 H7519 be held for further study.

In California, legislators have taken a slightly different approach. There, new data breach legislation was introduced on March 28, 2014, in the form of amended A.B. 1710. Rather than require credit reports or credit monitoring, A.B. 1710 would require businesses that suffer a data breach to offer "appropriate identity theft prevention and mitigation services." These services — which are not defined in the bill — would have to be offered at no cost to affected consumers for at least two years if the data breach exposed the consumer's name in combination with a social security number, a driver's license number, or California identification card number. The California Assembly passed A.B. 1710 on May 27, 2014, and the bill is currently being considered by the California Senate. Shortly after taking up the bill, the Senate amended it to reduce the length of time that identity theft prevention and mitigation services must be provided to one year.

Legislators are no longer willing to leave it up to businesses to decide whether to offer free credit monitoring or identity theft prevention services to consumers affected by a data breach.

Florida legislators have added a further twist in the form of the newly enacted Florida Information Protection Act of 2014. That law, which took effect on July 1, 2014, does not require businesses that suffer a data breach to offer free credit monitoring or identity theft prevention services. Rather, it requires businesses to notify Florida's attorney general as to whether free credit monitoring, identity theft, or any other "services related to the breach" are, or will be, offered to affected consumers. Although businesses do retain discretion as to whether to offer free services in the wake of a breach, having to discuss the matter with the attorney general does create an incentive to provide them.

It remains to be seen how many of the aforementioned bills will be passed into law or whether other states will try to introduce similar requirements. One thing is clear — legislators are no longer willing to leave it up to businesses to decide whether to offer free credit monitoring or identity theft prevention services to consumers affected by a data breach. Going forward, the costs of providing such services may become an unavoidable cost in every data breach incident.

MANDATORY "MADE-IN" LABELING IN THE EU

By Alistair Maughan

The European Union has taken the next step toward a mandatory system for "made-in" labeling on non-food consumer products in Europe, replacing the current voluntary system.

In April 2014, the European Parliament adopted a proposal to amend an existing proposed regulation dealing with consumer product safety that would have the effect of implementing mandatory made-in labeling. The aim is to improve traceability of goods and strengthen consumer protection.

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At present, a voluntary system of made-in labeling exists in the EU, and it is this system that would be replaced by the current proposal when it becomes adopted. The European Parliament believes that mandatory made-in labeling should apply to almost all goods sold on the EU market with a few exceptions, such as medicine.

The new system will apply to products whether produced inside the EU or imported into the EU from a third country. EU manufacturers may be able to choose whether to label products with "made in the EU," or specify a particular country. At present, however, "made in the EU" may not satisfy other countries, particularly the United States, where that label would not be accepted as a sufficient indication of a particular country.

The European Parliament believes that mandatory made-in labeling should apply to almost all goods sold on the EU market with a few exceptions, such as medicine.

More controversially, the European Parliament has also proposed the introduction of rules that would require the European Commission to draw up a public EU-wide blacklist of firms that are repeatedly found intentionally to infringe EU product safety rules.

To pass, the proposed regulation needs to be jointly adopted by the European Parliament and the Council. The Commission believes that the regulation will start to apply in 2015. Because it is a regulation, it will have direct effect in EU Member States and will not need to be separately implemented by national implementing legislation.

In relation to goods produced in more than one place, the "country of origin" for the purposes of mandatory labeling would be the country where the manufactured product underwent the last substantial processing resulting in the eventual product, or the last important stage of the manufacture. This presents the potentially difficult task of identifying where and when that might be.

The European Parliament also wants to increase the penalties for breach of these new regulations to take into account the seriousness, duration, and intention or recurring nature of any infringement, as well as the size of the company. Interestingly, however, the penalties will be determined by the national enforcement authorities of each Member State, and so could vary between different EU countries.

The European Parliament has suggested that penalties should not exceed 10% of annual total revenues for the worst offenses, although given the size of most companies involved in the supply of consumer products, that could be a huge amount.

Although the issue of penalties can be expected to be clarified over the next few months in the EU legislative process, the basic labeling requirement of the new regulations is unlikely to be modified. Affected manufacturers should take steps now to adjust to the forthcoming requirements on products sold into the EU market.

A NEW DAWN FOR CALIFORNIA CLASS ACTIONS

By William Stern

"There are three kinds of lies: lies, damned lies and statistics." The California Supreme Court could have been channeling Mark Twain when it rejected, emphatically, the unbridled use of statistical sampling to prove liability in a class action wage/hour case. In a unanimous decision, California's high court in *Duran v. U.S. Bank National Association*, No. S200923 (May 29, 2014) gave the heave-ho to the kind of "trial by formula" that has become a feature of modern-day wage/hour litigation. At the same time, the court restored some sanity to class action litigation generally.

FACTS OF *DURAN*

This class action was filed against U.S. Bank on behalf of 260 business banking officers (BBOs) who claimed they were denied overtime pay and meal/rest breaks. Liability turned on whether the bank misclassified the BBOs as exempt under the "outside salesperson" exemption, which applies to someone who spends more than 50% of the workday on sales activities outside the branch.

Round one: liability. How would plaintiffs prove that all 260 were misclassified? The trial court turned to statistics. It took testimony from 21 "sampled" class members who said they spent less than 50% of their time outside the branch, and concluded (by extrapolation, based on testimony from plaintiffs' statistical expert) that *all* 260 BBOs had been misclassified. There was just one small problem: 75 class members — read: 28% of the class — filed sworn declarations saying they had not been misclassified. The trial court rejected that evidence and found the bank liable.

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Round two: damages. At the damages phase, the trial court excluded the 75 declarations. Instead, the court took testimony about the average number of hours worked by the "21" employees, reckoned that the same was true for all, and awarded the class $15 million — including $6 million awarded to the 75 BBOs who admitted under oath they had no claim.

Judgment reversed. In 2012, the Court of Appeal reversed the judgment, concluding that the trial court's flawed trial plan amounted to an improper "trial by formula" which deprived the employer of its due process rights because the employer could not raise individual challenges to absent class members' claims. The Court of Appeal also ordered the class decertified.

WHY *DURAN* MATTERS

The California Supreme Court opened with a stout denunciation of the trial court's plan, calling it "profoundly flawed." The court affirmed the appellate court's reversal, and in doing so it imposed new substantive and procedural hurdles. Those hurdles have re-ordered how class actions will proceed in all California class actions, not just employment class actions.

Substance – Statistical Sampling Generally

A due process right to prove defenses. Regardless of the kind of class action case (employment or otherwise) and regardless whether statistical sampling is used, a defendant has a due process right to litigate its individual affirmative defenses. This is fundamental. (*Duran*, slip opn. at 38; see also id. at 29 ("any trial must allow for the litigation of affirmative defenses . . .").)

"These principles derive from both class action rules and principles of due process." (*Id.*, at 31.)

Statistical sampling to prove liability. As for statistical sampling to prove liability, it is not banned altogether. However, it has to be carefully controlled. Said the *Duran* court:

> We need not reach a sweeping conclusion as to whether or when sampling should be available as a tool for proving liability in a class action. It suffices to note that any class action trial plan, including those involving statistical methods of proof, must allow the defendant to litigate its affirmative defenses. If a defense depends upon questions individual to each class member, the statistical model must be designed to accommodate these case-specific deviations. If statistical methods are ultimately incompatible with the nature of the plaintiffs' claims or the defendant's defenses, resort to statistical proof may not be appropriate. Procedural innovation must conform to the substantive rights of the parties. (*Id.*, slip opn. at 38.)

Statistics can't be the only "glue." Moreover, evidence of liability common to each class member other than through statistics must come first. It cannot be created through, or replaced by, statistics: "Statistical methods cannot entirely substitute for common proof, however. There must be some glue that binds class members together apart from statistical evidence." (*Id.*, at 26.) As the *Duran* court said: "Class actions do not create a requirement of common evidence. Instead, class litigation may be appropriate if the circumstances of a particular case demonstrate that there *is* common evidence." (*Id.* at 33.)

Read our Class Action Defender blog.

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Procedure – A Manageable Trial Plan at the Class Certification Stage

A plaintiff who seeks to use statistical evidence to prove liability must meet a set of new criteria. If the trial plan will include statistical evidence, the court should consider *at the certification stage* whether a trial plan has been developed to address its use.

For one thing, a plaintiff must now prove manageability. This was optional pre-*Duran*.

Also, the bar has been raised. The trial court must conduct a preliminary assessment "to determine the level of variability in the class. If the variability is too great, individual issues are more likely to swamp common ones and render the class action unmanageable." (*Duran,* slip opn. at 30.)

What did the court mean by variability? "[A] defense in which liability itself is predicated on factual questions specific to individual claimants poses a much greater challenge to manageability" than individual questions regarding the calculation of damages. (*Id.* at 25.) "[T]he trial court could not abridge [the bank's] presentation of an exemption defense simply because that defense was cumbersome to litigate in a class action." (*Id.* at 31.) And "[i]f a defense depends upon questions individual to each class member, the statistical model must be designed to accommodate these case-specific deviations." (*Id.* at 38.)

ALL MISCLASSIFICATION CASES NOW IN DOUBT

The *Duran* court went further. It not only called into question a tool commonly used by the class action bar to bring wage/hour cases, it cast doubt on the future of misclassification cases themselves — even those that do not rely on sampling! Said the court: "[A]n employer's liability for misclassification *under most Labor Code exemptions* will depend on employees' individual circumstances." (*Id.*, at 33 (italics added).) By that, the *Duran* court seems to be saying that misclassification cases invariably raise inherently individual issues, no matter which Labor Code exemption is used.

NO, IT CAN'T BE SORTED OUT LATER

The *Duran* court took a stroll through a neighborhood of class action law that has been roiling with controversy: The "overbroad class."

Class action plaintiffs always contend that everyone in the class was harmed, and will calculate classwide damages by multiplying the number of all class members times the average damage per class member. This leads

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- French Consumer Association Takes on Internet Giants

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to the "overbroad class," where persons are included in the class simply by virtue of the broad definition (e.g., all persons who bought a certain product, worked for an employer during a certain time period, or clicked on a webpage, etc.). In such cases, the damage figure is wildly inflated by the inclusion of persons who have no claim.

"No matter," says the class action bar, "this can be sorted out in the claims process," or in "Phase II, the damages phase, after liability is decided." "By the way," class counsel will say, "the damages phase is also where defendant can assert its now-meaningless due process right to bring individual defenses." In other words, plaintiff gets to assemble his or her damages case by multiplication. But defendant has to *dis*-assemble that figure by subtraction. That is an impossible task, and effectively creates a presumption of classwide harm.

To date, no California appellate court has directly addressed this nonsensical argument. Until now. The *Duran* court said: "Only in an extraordinary situation would a class action be justified where, subsequent to the class judgment, the members would be required to individually prove not only damages but also liability." (*Duran,* slip opn. at 25.)

CONCLUSION

Duran will affect every California class action, employment and otherwise, whether on file now or still just a glimmer in class counsel's eye. And if the claim is brought under California's Labor Code or unfair competition law, *Duran* could affect class actions pending in federal court. Businesses facing class action exposure should review their case list and ask, "How has *Duran* changed this case?"

Morrison & Foerster filed an amicus brief on behalf of California Bankers Association, California Business Roundtable, and Civil Justice Association of California.

KEY COURT DEVELOPMENTS

U.S. Supreme Court Rejects Broad FDA Preclusion in *Pom Wonderful* Lanham Act Case

The U.S. Supreme Court held that competitors can bring Lanham Act claims like Pom Wonderful's challenging food and beverage labels regulated by the FDA. While a blow to FDA primacy in the context of federal business-to-business Lanham Act claims, the Supreme Court made clear that *Pom Wonderful* does not address the preemption of state law claims. This ruling creates uncertainty for the food and beverage industry, and paves the way for more competitor false advertising disputes. Learn more.

Consumer Rights and Wrongs: Are You Ready for the New EU Consumer Contracts Rules?

The EU Consumer Rights Directive (2011/83/EU) was introduced in 2011 with the aim of harmonizing and simplifying consumer protection legislation in the EU. Incorporation of the Directive into national laws was required by December 13, 2013, with Member States applying the national laws implementing the Directive starting June 13, 2014.

In this Alert, we summarize the new EU rules and examine the approach to implementation taken by five EU member states in particular. Learn more.

Websites Hit with Demand Letters on Accessibility Issues Despite Courts' Rejection of Claim

Numerous businesses have recently received letters asserting that their websites are not accessible to persons with disabilities, in violation of the Americans with Disabilities Act and California's Unruh Act. These letters threaten litigation and warn of large penalty claims under the Unruh Act. Learn more.

For other consumer product + retail-related legal updates, click here.

IN CASE YOU MISSED IT...

Our recent webinar "Big Data and the Internet of Things – From Theory to Practice" is available on demand by clicking here.

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