ROPES & GRAY

ALERT

Privacy & Data Security

June 29, 2016

District Court Ruling in *FTC v. Amazon* Carries Implications for Data Security Breach Cases

Attorneys
Heather Egan Sussman
Douglas H. Meal
James S. DeGraw
Rohan Massey
Seth C. Harrington
David M. McIntosh
Mark P. Szpak
Michelle Visser
Paul D. Rubin
Marc P. Berger
Laura G. Hoey
David T. Cohen

Since the outset of its controversial foray into the data security space, the Federal Trade Commission ("FTC" or "Commission") has cited its statutory power to seek injunctive relief as a basis for bringing actions against companies that, in the FTC's view, violated Section 5 of the FTC Act by allegedly failing to maintain reasonable and appropriate data security practices. But a recent decision outside the data security context from the United States District Court for the Western District of Washington, *Federal Trade Commission v. Amazon.com, Inc.*,[1] has the potential to undermine this claim of authority in data breach cases, particularly as to injunctions sought in federal court. While the decision ultimately held Amazon liable for an unfair trade practice and suggested that equitable money relief would be awarded, the Court's denial of injunctive relief – the FTC's primary, if not only, basis for proceeding in data security breach cases – potentially offers corporate victims of data security breaches a powerful defense against FTC suits alleging that the company's data security practices violated Section 5 of the FTC Act.

A Limit to the FTC's Power to Obtain Injunctions

Amazon does not itself concern data security, but an allegedly unfair marketing practice. Specifically, the decision involves Amazon's practice of providing consumers with applications for mobile devices that allowed "in-app purchases," which Amazon allegedly did without providing sufficient notice or parental controls. By the time of the decision, Amazon had discontinued or modified the allegedly unfair practice, except with respect to certain older Kindle devices that had been off the market for several years and that no longer received software updates. Nevertheless, the FTC argued that the practices not only were "unfair" within the meaning of Section 5 of the FTC Act, but also were "likely to continue to injure consumers, reap unjust enrichment, and harm the public interest," and, as such, were properly remedied by injunction under Section 13(b) of the FTC Act.[2]

Section 13(b) authorizes the FTC to seek judicial injunctions where a violation of the FTC Act is ongoing or likely to occur. Despite the statute's requirement of an ongoing or anticipated violation, the FTC frequently seeks such injunctions based on a past practice or occurrences. But the *Amazon* Court rejected this approach. Observing that "[p]ast violations of the FTC Act do not justify the imposition of a permanent injunction," the Court instead looked at whether the FTC had established "evidence of a recurring violation," as the statute requires. The Court noted that injunctions had been deemed appropriate where companies "engaged in continuous, fraudulent practices" of a "systemic nature," and concluded that such a pattern was not evident on the facts. As such, there was no cognizable danger of a recurring violation, and therefore no basis for a permanent injunction.

The implications of the ruling for the FTC's data breach enforcement actions are significant. The alleged legal violation in a data breach case – a supposed failure to have sufficient information security practices – frequently lasts only up to the point of the breach. After the breach, a company typically invests heavily in data security upgrades,

[1] *Federal Trade Commission v. Amazon.com, Inc.*, C134-1038-JCC (W.D. Wash. Apr. 26, 2016).
[2] Codified at 15 U.S.C. § 53(b).

meaning that any potential violation of law is likely to have occurred—and ended—significantly before the FTC makes its case to a judge, and in many cases before it even commences its enforcement action.

Accordingly, post-*Amazon*, data breach victims enter FTC settlement negotiations with added leverage: if a victimized company can show it has taken, and will continue to take, steps to improve data security post-breach, the FTC will have a much harder time using its power to seek injunctive relief as a cudgel.

Liability Ruling

Amazon is not all good news for potential defendants. On the question of liability, the Court granted summary judgment to the FTC that Amazon's practices constituted an "unfair" practice under Section 5, and suggested that equitable money relief would be awarded in an amount to be determined. In finding liability, the Court rejected Amazon's argument that the codified prerequisites for unfairness found in Section 5(n)—which require substantial, unavoidable injury to consumers that is not outweighed by countervailing benefits—are not in and of themselves sufficient to establish that a practice is "unfair," and that instead some measure of culpable conduct must also be proven for liability to exist under Section 5's unfairness prong. The justification for the approach urged by Amazon lies in the wording of the Section 5(n) statutory prerequisites themselves (which on their face set the outer bounds of unfairness)[3] and in the FTC's December 17, 1980 Policy Statement on Unfairness. In the Policy Statement, the Commission defended itself against claims of having overreached in the past in exercising its "unfairness" authority by assuring Congress that going forward it would not exercise that authority except in cases where the practice in question had caused substantial, unavoidable consumer injury without countervailing benefits, and by further assuring Congress that even in those cases its determination whether the practice in question was "unfair" would be informed by whether the practice also violated an established public policy. Consistent with these assurances in the Policy Statement, as well as the statutory text and the legislative history[4] of the 1994 amendment to the FTC Act that was intended to codify those assurances, some decisions have found that the Section 5(n) prerequisites, while being *necessary* for unfairness liability to attach to a practice, are not, or are not necessarily, in and of themselves *sufficient* to establish liability for unfairness.[5]

Amazon went the other way, however, ruling that Section 5 unfairness liability attaches when the Section 5(n) pre-requisites have been established – period. The Court defended this ruling by citing Ninth Circuit decisions that purportedly applied the Section 5(n) statutory requirements "without embellishment" in reaching their holdings. However, neither of the two Ninth Circuit decisions cited by the *Amazon* Court required the Ninth Circuit to decide—and these two appellate decisions accordingly did not affirmatively decide—whether or not consideration of additional factors was necessary to a finding of unfairness.[6] Moreover, a Third Circuit decision that the Court

---

[3] *See* 15 U.S.C. § 45(n) ("The Commission *shall have no authority* under this section or section 57a of this title to declare unlawful an act or practice on the grounds that such act or practice is unfair *unless* the act or practice causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition. *In determining whether an act or practice is unfair, the Commission may consider established public policies as evidence to be considered with all other evidence.* Such public policy considerations may not serve as a primary basis for such determination.") (Emphasis added).

[4] *See* S. REP. 103-130, 1993 WL 322671, at *12 (Aug. 24, 1993) (statutory prerequisites are "intended to codify, as a *statutory limitation* on unfair acts or practices, the principles of the FTC's December 17, 1980, policy statement on unfairness, reaffirmed by a letter from the FTC dated March 5, 1982").

[5] *FTC v. Wyndham Worldwide Corp.*, 799 F.3d 236, 244 (3d Cir. 2015) (stating that the elements enumerated in Section 5(n) may be necessary but insufficient conditions for unfairness liability); *In re LabMD, Inc.*, No, 9357, 2015 WL 7575033 (F.T.C.), *37-38 (Nov. 13, 2015) (noting that the elements of Section 5(n) "establish an outer limit" on the FTC's authority).

[6] One of the decisions cited in *Amazon*, *Davis v. HSBC Bank*, 691 F.3d 1152, 1168-69 (9th Cit. 2012), merely held that the three elements of 45(n) were *necessary* for a finding of unfairness, *id*. at 1168-69 ("Nor were the advertisements unfair. A practice is 'unfair' under section 5 *only if* it 'causes or is likely to cause substantial injury to consumers which is not reasonably avoidable by consumers themselves and not outweighed by countervailing benefits to consumers or to competition.'"), and concluded these elements were not met. Although the other decision, *FTC v. Neovi*, stated that the three-prong test was sufficient for determining liability, 604 F.3d 1150, 1155 (9th Cir. 2010), the defendant in that case did not argue—and the court accordingly did not

characterized as having "declined to adopt those additional requirements" in fact expressly stated that "[t]he three requirements in § 45(n) may be necessary rather than sufficient conditions of an unfair practice.[7]

Amazon's finding of liability is even more clearly out of step with the majority of courts where it touches upon the existence of consumer injury. In concluding that the FTC sufficiently proved substantial, unavoidable consumer injury under Section 5(n), the Court held that the "time [consumers] spent pursuing . . . refunds constitutes additional injury to Amazon's customers." This conclusion, however, is inconsistent with rulings—both in Section 13 cases and in putative class actions—that lost time is neither a substantial consumer injury within the meaning of the FTC Act, nor an injury-in-fact for purposes of Article III (or any other) standing, nor a cognizable injury sufficient to withstand a motion to dismiss.[8]

The Court's liability ruling also opened up the possibility that Amazon will be required to pay significant monetary relief. Data breach defendants, however, may often have powerful arguments that such relief is unavailable. For example, such relief is frequently limited to situations where the defendant knowingly engaged in wrongful conduct,[9] whereas data breaches typically result, at most, from a company's honest but unsuccessful effort to protect the security of consumer information. It thus remains to be seen whether *Amazon*'s ruling on liability and monetary relief will actually be deemed to support relief against data breach defendants.

Conclusion

The FTC, the plaintiffs' bar, and breached companies will all find something to cheer about in *Amazon*. Ultimately, though, what the Court got right on remedy is probably more important to data breach defendants in the long run than what it got wrong on liability. Accordingly, the decision may offer a ray of hope to businesses targeted by the FTC in the wake of a data security breach.

For more information regarding *FTC v. Amazon* or to discuss data security practices generally, please feel free to contact Heather Egan Sussman, Doug Meal, Jim DeGraw, Rohan Massey, Seth Harrington, David McIntosh, Mark Szpak, Michelle Visser, Paul Rubin, Marc Berger, Laura Hoey, David Cohen, or another member of Ropes & Gray's leading privacy & data security team.

---

consider, or need to consider—whether any additional factors had to be proved. *See* Brief of Appellants, Dkt. No. 14, *FTC v. Neovi*, 09-55093 (9th Cir. May 19, 2009) at 1 (framing relevant "Issue Presented" only as whether evidence supported the inference that appellants in fact engaged in business practices that caused material injury to consumers). Moreover, in applying the three-prong test, the *Neovi* court clearly embedded a culpability requirement in its finding that the defendant caused substantial consumer injury. *Id*. at 1155 (observing that defendant "turned a blind eye" to the extensive fraud it was facilitating). It is thus highly questionable whether the *Amazon* court correctly read *Neovi* as holding that Section 5 'unfairness' can be proven without satisfying a culpability requirement.

[7] *Wyndham*, 799 F.3d at 244-45.

[8] *See, e.g. Wyndham*, 799 F.3d at 247 (comparing "burdensome . . . requirements for declaring acts unfair" under Section 5 with sweeping authority under the Gramm-Leach-Bailey Act to regulate conduct that causes "substantial harm or *inconvenience to any customer*") (emphasis in original); *Whalen v., Michael Stores Inc.*, 14-cv-7006, 2015 WL 9462108, *3 (E.D.N.Y. Dec. 28, 2015) (alleged lost time and money associated with credit monitoring and other mitigation expenses insufficient to confer standing); *Shafran v. Harley-Davidson, Inc.*, 07-cv-1365, 2008 WL 763177, *3 (S.D.N.Y. Mar. 20, 2008) ("time and expense of credit monitoring . . . is not, in itself, an injury that the law is prepared to remedy"); *but see Remijas v. Nieman Marcus Grp.*, LLC, 794 F.3d 688, 694 (7th Cir. 2015) (holding measures taken by consumers to obtain reimbursement for fraudulent charges in wake of data breach were, under the facts presented in the case, sufficient for standing); *FTC v. Neovi*, Inc., 598 F.Supp.2d 1104 (S.D. Cal. 2008) (finding substantial harm where consumers "often spent a considerable amount of time and resources" remedying the effects of fraud).

[9] *E.g., FTC v. Int'l Diamond Corp.*, No. C-82-0878, 1983 WL 1911, at *2 (N.D. Cal. Nov. 8, 1983) (holding that the "type of activity for which a defendant will be liable for redress under Section 13(b) must rise to the level of dishonesty or fraud").