Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

# Banks Held To Higher Standard In Schnucks Breach Ruling

By **Allison Grande**

*Law360, New York (September 29, 2016, 9:06 PM EDT)* -- An Illinois federal judge placed significant weight on the sophistication of the business relationship between banks and their merchants in nixing financial institutions' claims over a data breach at grocer Schnucks on Wednesday, signaling that banks may not have as easy a time as affected consumers getting away with sweeping assertions about data security shortcomings.

In his 37-page ruling, Chief Judge Michael J. Reagan of the Southern District of Illinois handed Schnuck Market Inc. a win by granting the grocer's motion to dismiss the 13-count complaint lodged by Community Bank of Trenton, University of Illinois Employees Credit Union and two other payment card issuers over a breach that compromised 2.4 million shoppers' data between December 2012 and March 2013.

Although he did leave the door open for the banks to replead all but two of their claims, Judge Reagan voiced serious doubts about the plausibility of their slew of racketeering, negligence, contract and fraud claims, calling the assertions "highly general" while stressing the "critical distinction" between the relationship that the grocer had with financial institutions compared to how it interacted with consumers who have also raised claims over the breach.

"Because [the financial institution] plaintiffs were a more sophisticated group, the court expected more particularized allegations of representations and failures of protecting and securing the data," Polsinelli LLP principal Zuzana Ikels said. "In other words, the general allegations — of failure to comply with data security measures — were insufficient vis-à-vis this group of plaintiffs."

Retailers and other businesses are increasingly facing class actions from both consumers and banks in the wake of high-profile breaches such as the one that hit Schnucks three years ago. Target, Home Depot, Kmart, Wendy's and Noodles & Co. are among some of the most notable businesses that have had to fend off litigation brought by disgruntled consumers who claim their data was compromised or misused and financial institutions seeking to recoup losses that they incurred as a result of replacing cards and otherwise helping their customers following a breach.

On the consumer front, plaintiffs have often been stymied by the conclusion that they have not alleged economic or other concrete harm sufficient to maintain Article III standing. However, consumers in recent years have been finding a more receptive audience for their claims within the Seventh Circuit, where the Southern District of Illinois is located.

Within the last two years, the Seventh Circuit has bucked the trend with its sister circuits in reviving a pair of putative consumer class actions over data breaches at retailer Neiman Marcus and restaurant chain P.F. Chang's on the grounds that the assertion of fraud-prevention expenses was enough to establish standing.

And even Schnucks customers have benefited from the circuit's seeming acceptance of these claims, with an Illinois federal judge in August 2015 denying the grocer's bid to escape a suit brought by more than 200 customers on the grounds that the plaintiffs had clearly alleged they had already suffered economic harm from the breach. Schnucks subsequently settled the suit with 199 of these plaintiffs while the remaining six saw their claims nixed by the court earlier this year after they failed to respond to court inquiries.

Claims brought by financial institutions have been rarer than those mounted by consumers, but banks have largely found success to date in pursuing their claims at least at the outset.

"While demonstrating harm in consumer class actions arising from payment card breaches is difficult because consumers are refunded for any fraudulent charges to their card, demonstrating harm in lawsuits brought by financial institutions left 'holding the bag' for refunding consumers for fraudulent charges should theoretically be easier," Shook Hardy & Bacon LLP data security and privacy group co-chair Al Saikali said. "There is a more concrete harm financial institutions can allege."

In both the Home Depot and Target litigation, the banks snagged early and significant victories. Specifically, the Target court refused to toss most of the case after finding that the retailer owed card issuers a duty to protect customer credit and debit card information from hackers and subsequently agreedto certify a class of all financial institutions that issued cards affected by the hack. Meanwhile, the Home Depot court elected to preserve the overwhelming majority of financial institutions' claims in May.

Target ultimately reached a $39 million settlement with the banks that was given final approval earlier this year while Home Depot is seeking permission to bring to the Eleventh Circuit several questions of law, including whether banks have standing at all, that were raised by a judge’s refusal to toss data breach claims.

In the Schnucks case decided Wednesday, the judge highlighted in a footnote that while standing has been "scrutinized closely" in much of the other data breach litigation that has passed through the courts, "that issue has not been put before the court at this juncture, so the court is not considering the harms stated from that perspective without the benefit of argument from the parties."

With the issue of standing put aside, the court was free to take the rare step of delving into the substantive claims that were pled.

"Unfortunately, whatever guidance we might have gotten from this case is marred by the fact that the plaintiffs cobbled together whatever theories they could think of, and many of their theories, such as [the Racketeer Influenced and Corrupt Organizations Act] and breach of fiduciary duty, seem to have no place in a data breach case," Hughes Hubbard & Reed LLP data privacy and cybersecurity group co-heads Dennis Klein and Seth Rothman said in a joint email.

Besides going through the financial institutions' claims one at a time, Judge Reagan also took the unique step of suggesting that banks be held to a higher pleading standard than the average consumer due to

the complex business relationship they have with the defendant.

Distinguishing the instant action from consumer suits such as the resurrected litigation against Neiman Marcus and P.F. Chang's, the judge wrote that consumers effectively illustrate plausible claims for relief under various theories "by appealing to the common life experience of a consumer walking into a merchant to buy a sandwich or a book." The concrete fraud charges that "typically" appear on at least a few plaintiffs' payment cards coupled with "the familiar expectations of a store customer make the claims in those cases hold together to illustrate a plausible story," the judge said.

"This case is a perfect example of how courts may have different expectations of how you meet the plausibility standard depending on who you are," Ikels said. "The court seems to be saying that if you're a financial institution, you have more knowledge about what exactly would have been a misrepresentation or a failure because your relationship with the merchant is more of an equal business relationship and not the casual one of a consumer who just wanted to go in and buy a book, and therefore you can't just get away with generalized allegations."

Noting that the landscape for these type of financial institution cases is relatively uncharted, Ikels added that the Illinois judge's decision seems to indicate that while courts appear to be getting more comfortable with letting lax data security and false misrepresentation allegations play out when it comes to individual consumers, "they need more than just the fact that [the breach] occurred to make them comfortable when it comes to disputes between two sophisticated businesses."

Moving forward, the banks will have a chance to amend their complaint to raise "more substantive pleadings," as the judge put it.

In completing this task, the financial institutions are likely to look at the handful of cases that Judge Reagan pointed to in his ruling that raised allegations that were specific enough to sustain similar claims, such as the allegations put forth in the Home Depot data breach case that the retailer had received and ignored numerous warnings that its data security was insufficient, attorneys say.

Finding these particularized hooks may be easier for some claims than for others, such as the banks' allegation that Schnucks violated RICO by engaging in bank and wire fraud in processing customer transactions and by conspiring to take proceeds from its fraudulent activities to reinvest in its ongoing business operations.

"It's a powerful distinction that the judge made that these RICO claims don't make sense in the context of who these two parties are and that it rings hollow to suggest that a merchant is negligently trying to cheat or defraud a financial institution because that would make no business sense," Ikels said.

As the case marches on, attorneys say that it will definitely be one to watch, both to see how the district court reacts to the banks' claims if and when they are revamped and how an appeal might play out, given the Circuit's track record in similar cases.

"If [it goes up on appeal], it will be interesting to see what the Seventh Circuit does, given the low bar for standing in consumer data breach cases established in the Neiman Marcus case," Saikali said.

The banks are represented by John J. Driscoll and Christopher J. Quinn of the Driscoll Firm PC, Richard L. Coffman of The Coffman Law Firm, Gary R. Lietz of Lietz Banner Ford LLP, Mitchell A. Toups of Weller Green Toups & Terrell LLP and G. Robert Blakey of Notre Dame Law School.

Schnuck is represented by Daniel R. Warren of BakerHostetler and Russel K. Scott of Greensfelder Hemker & Gale PC.

The case is Community Bank of Trenton et al. v. Schnuck Markets Inc., case number 3:15-cv-01125, in the U.S. District Court for the Southern District of Illinois.

--Editing by Christine Chun and Kelly Duncan.

---