## Heads of the FTC Push Back on Chief Administrative Law Judge and Find Consumer Harm in LabMD Data Leak

On July 29, 2016, the three Federal Trade Commission ("FTC") commissioners vacated their chief administrative law judge's bold decision to dismiss the agency's action against a medical testing lab, LabMD, In the *Matter of LabMD Inc.*, No. 9357. The commissioners concluded that LabMD's data security practices were unreasonable and constituted an unfair act or practice that violated Section 5 of the Federal Trade Commission Act. More importantly, the commissioners' decision addressed the issue of standing when there has been no affirmative showing of harm in data breach cases.

In November 2015, Judge D. Michael Chappel dismissed the FTC's complaint against LabMD Inc. The administrative law judge ("ALJ") concluded a mere possibility of consumer harm was insufficient to prove unfairness under Section 5(n) of the FTC Act. In his order, he defined the phrase "likely to cause" to mean "having a high probability of occurring or being true." Applying this standard, the ALJ rejected complainant's counsel's argument that identity and medical identity theft-related harms were "likely" for consumers whose personal information was maintained on LabMD's computer network. He concluded that, "[a]t best, Complaintant's Counsel has proven the 'possibility' of harm, but not any probability' or likelihood of harm."

On July 29, 2016, the commissioners disagreed. They found that the ALJ applied the wrong legal standard for unfairness and that LabMD's security practices were unreasonable because they resulted in unauthorized disclosure of patients' medical data, which caused "substantial injury" to customers.

Section 5 of the FTC Act authorizes the commission to challenge "unfair or deceptive acts or practices in or affecting commerce." 15 U.S.C. §45(a). In 1994, Congress added Section 5(n) to the FTC Act, providing that an act or practice may be deemed unfair if (1) it "causes or is likely to cause substantial injury to consumers"; (2) the injury "is not reasonably avoidable by consumers themselves"; and (3) the injury is "not outweighed by countervailing benefits to consumers or competition." 15 U.S.C. § 45(n).

The commissioners' opinion discusses that the first prong of Section 5(n) also includes a causation requirement that is satisfied where a practice "causes . . . substantial injury." 15 U.S.C. § 45(n). It found that the underlying action does not need to be the only or most proximate cause of an injury to meet this test. Citing the *FTC v. Wyndham Worldwide, Inc.*, 799 F.3d 236, 243 (3d Cir. 2015) case, the commissioners referenced the Third Circuit's opinion "that a company's conduct was not the most proximate cause of an injury generally does not immunize liability from foreseeable harms." 799 F.3d at 246. While a finding of unfairness requires that the injury in question be "substantial," a substantial injury may be demonstrated by a showing of a small amount of harm to a large number of people, as well as a large amount of harm to a small number of people.

The commissioners' opinion discusses that a practice may also meet the first prong of Section 5(n) if it is "likely to cause substantial injury." ("[T]he FTC Act expressly contemplates the possibility that conduct can be unfair before actual injury occurs."). In determining whether a practice is "likely to cause a

substantial injury," the commissioners state that they will look to the likelihood or probability of the injury occurring and the magnitude or seriousness of the injury if it does occur. Thus, a practice may be unfair if the magnitude of the potential injury is large, even if the likelihood of the injury occurring is low.

Under the second and third prongs of Section 5(n), the commissioners ask whether consumers could have reasonably avoided the asserted injury and whether it is outweighed by countervailing benefits. *Orkin Exterminating Co., Inc. v. FTC*, 849 F.2d 1354, 1363-64 (11th Cir. 1988) (Commission's "definition of 'unfairness' focuses upon unjustified consumer injury").

In the opinion of the commission, Chairwoman Edith Ramirez wrote about LabMD,

Among other things, it failed to use an intrusion detection system or file integrity monitoring; neglected to monitor traffic coming across its firewalls; provided essentially no data security training to its employees; and never deleted any of the consumer data it had collected. These failures resulted in the installation of file-sharing software that exposed the medical and other sensitive personal information of 9,300 consumers on a peer-to-peer network accessible by millions of users. LabMD then left it there, freely available, for 11 months, leading to the unauthorized disclosure of the information.

**Takeaways**

***Enforcement actions based on alleged inadequate security*:** While the ALJ opinion questioned whether enforcement actions based on inadequate security, without other evidence of the actual likelihood of consumer harm, is sufficient. The July 29, 2016, order determines that it was.

***Evidence of consumer injury*:** While the ALJ found that theorizing that the harm could occur was not sufficient to support standing in data breach class actions, the opinion by the commissioners indicates that theoretical harm is insufficient.

***Exposure is enough*:** The commission's position is that the mere exposure of sensitive information is sufficient to show causation of substantial injury under Section 5 regardless of whether there is evidence of misuse.

***FTC is empowered*:** It is clear that the commissioners believe that they can and will continue to exercise the FTC's authority to take enforcement against unreasonable security practices until a court or Congress says that they cannot.

Leading up to the FTC's decision, there were indications that LabMD could impact the circuit split regarding standing in data breach class actions wherein various opinions have found that the "allegations of possible future injury are not sufficient" to establish standing, but that standing instead requires that harm be "certainly impending." *See, e.g., In re Zappos.com Inc., Customer Data Security Breach Litigation*, 2015 WL 3466943 (D. Nev. June 1, 2015); *Lewert v. P.F. Chang's China Bistro Inc.*, 2014 WL 7005097 (N.D. Ill. Dec. 10, 2014) and others found that preventative costs that cardholders might incur "easily" qualify as concrete injuries sufficient for the plaintiffs to establish standing to sue.

Given the FTC's decision, it remains to be seen how the courts will address standing in data breach class actions and whether they will follow the commissioners' opinion or use the ALJ's reasoning as a basis to dismiss actions on standing. LabMD has 60 days to file a petition for review with a U.S. Court of Appeals, which it likely will.

**Jonathan C. Sandler**
Shareholder
**jsandler@bhfs.com**
310.564.8672

**Richard B. Benenson**
Shareholder
**rbenenson@bhfs.com**
303.223.1203

**Makan Delrahim**
Shareholder
**mdelrahim@bhfs.com**
310.500.4607