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Protecting Confidential Information Entrusted to Others in Business Transactions: Data Breaches, Identity Theft, and Tort Liability

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PROTECTING CONFIDENTIAL INFORMATION ENTRUSTED TO OTHERS IN BUSINESS TRANSACTIONS: DATA BREACHES, IDENTITY THEFT, AND TORT LIABILITY

*Mark A. Geistfeld**

> These days, it is almost impossible to be in business and not collect or hold personally identifying information—names and addresses, Social Security numbers, credit card numbers, or other account numbers—about your customers, employees, business partners, students, or patients. If this information falls into the wrong hands, it could put these individuals at risk for identity theft.[1]

I. INTRODUCTION

Because commerce is highly reliant on personally identifying information that is meant to be confidential, the theft of such data has become a profitable criminal enterprise. "Like thieves [who] rob banks because 'that's where the money is,' computer attackers target databases because that's where the data is."[2] Once in possession of an individual's confidential identifying information, an "identity thief can empty bank accounts, obtain credit cards, secure loans, open lines of credit, connect telephone services, and enroll in government benefits in a victim's name."[3] The profitability of identity theft explains the results of a U.S. Department of Justice (DOJ) study which found that "[a]n estimated 17.6 million persons, or 7% of all U.S. residents age 16 or older, were victims of one or more incidents of identity theft in 2014."[4]

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1. FED. TRADE COMM'N, INFORMATION COMPROMISE AND THE RISK OF IDENTITY THEFT: GUIDANCE FOR YOUR BUSINESS (2004), https://permanent.access.gpo.gov/lps104327/ftc/www.ftc.gov/bcp/edu/pubs/business/idtheft/bus59.pdf.

2. Phillip Britt, *Survey: Government Struggles with Data Breaches*, INFO. TODAY, Jan. 2006, at 48–49 (alteration in original).

3. Danielle Keats Citron, *Reservoirs of Danger: The Evolution of Public and Private Law at the Dawn of the Information Age*, 80 S. CAL. L. REV. 241, 252 (2007).

4. ERIKA HARRELL, BUREAU OF JUSTICE STATISTICS, VICTIMS OF IDENTITY THEFT, 2014, at 1 (2015), https://www.bjs.gov/content/pub/pdf/vit14.pdf.

Many identity theft victims incur little or no out-of-pocket financial loss. According to the DOJ study, 35% of identity theft victims in 2014 suffered no direct or indirect financial cost—a measure that does not include the time the victim spent to rectify matters.[5] "Half of identity theft victims who were able to resolve any associated problems did so in a day or less."[6] Other victims were not so lucky. Approximately 7% reported losses in excess of $100, with a mean loss of $2,895.[7] For those victims who were able to resolve the financial and credit problems caused by the identity theft, "about 9% spent more than a month" doing so (the rate rises to 32% if the victim "experienced multiple types of identity theft with existing accounts and other fraud").[8] Confronted by the worrisome potential for financial and credit problems, an "estimated 36% of identity theft victims reported moderate or severe emotional distress as a result of the incident."[9] Extreme cases involve even greater expense and presumably more distress.[10]

In light of the widespread incidence of identity theft and the corresponding losses, lawsuits have predictably followed. An empirical study identified 230 data breach lawsuits filed in federal courts from 2000 to 2010, most of which involved class actions filed against "large firms such as banks, medical/insurance entities, retailers, or other private businesses. . . . [T]he vast majority of cases either settle, or are dismissed, either as a matter of law, or because the plaintiff was unable to demonstrate actual harm."[11] The study "identified over 86 unique causes of action (from only 231 cases) for essentially the same event: the unauthorized disclosure of personal information," and "found 34 different kinds of tort causes of action, 15 contract, 4 violations of state statutes, and 33 violations of federal statutes."[12] As this study shows, data breaches potentially implicate a wide array of liability rules, but there is no claim that clearly dominates the others.

To evaluate the liability issues posed by tort litigation over data breaches—defined for our purposes as the theft of one's confidential

5. *Id.* at 6.

6. *Id.* at 1.

7. *Id.* at 1, 6 tbl.6.

8. *Id.* at 1, 10.

9. *Id.* at 1.

10. *See* Citron, *supra* note 3, at 253 (citing data for a class of identity theft victims who on average incurred $16,971 in lost income, including an average of $1,000 in out-of-pocket expenses, and over 600 hours of personal time).

11. Sasha Romanosky et al., *Empirical Analysis of Data Breach Litigation*, 11 J. EMPIRICAL LEGAL STUD. 74, 74–76 (2014).

12. *Id.* at 100.

information entrusted to another in a business transaction,[13] I will address the negligence cause of action. Negligence is the most common type of tort claim according to this study.[14] Negligence liability is also the default tort rule governing accidental harms, and so an extended analysis of these claims is likely to encompass the fundamental doctrinal issues and policy judgments involved in tort litigation over data breaches.

The analysis shows why plaintiffs so far have had little success in obtaining tort recovery for these instances of identity theft. A negligence claim requires a court to resolve apparently insurmountable issues pertaining to the elements of duty,[15] breach,[16] and compensable harm.[17] For each of these elements, the black-letter rules would seem to either bar the tort claim or make it extremely difficult for victims of identity theft to recover for their losses.

Although courts have dismissed negligence claims for these reasons, they have not adequately considered the underlying tort principles. Tort claims for data breach turn on a number of issues that require searching analysis, including the manner in which the economic loss rule affects the tort duty, the relation between the negligence standard of care and strict liability, and the appropriate forms of compensable loss. Substantive analysis of these issues shows that they all can be resolved in favor of the negligence claim, which in turn justifies a rule of strict liability. Plaintiff customers are likely to face considerable difficulties in proving that the theft of their confidential information was caused by defendant businesses negligently breaching their obligations to reasonably secure the data. For reasons recognized by tort law in analogous contexts, the evidentiary difficulties of proving negligence can justify a rule of strict liability for enforcing the tort duty to exercise reasonable care.[18] When formulated in this manner, the rule

13. Data breaches can also be caused by software programs that enable an unauthorized third party to hack into an individual's computer and steal her confidential information. *See generally* Michael L. Rustad & Thomas H. Koenig, *The Tort of Negligent Enablement of Cybercrime*, 20 BERKELEY TECH. L.J. 1553 (2005) (discussing the problem and proposing that software licensors be subject to a tort duty requiring them to incorporate reasonable security measures into their products and services). In many of the data breach cases that are the subject of my analysis, the cybersecurity problem will stem from the software that the defendant business licensed from a third party. To the extent that the defendant is subject to tort liability for the resultant identity thefts, it becomes incentivized to deal with reputable third-party software licensors or otherwise obtain a right to indemnity for these liabilities, thereby incentivizing these licensors to adopt reasonable cybersecurity measures in the first instance.

14. *Id.* at 101 fig.7.

15. *See infra* Part II.

16. *See infra* Part III.

17. *See infra* Part IV.

18. *See infra* Part III.

of strict liability supplies the necessary means for customers to adequately enforce the tort duty obligating businesses to adopt reasonable precautions for protecting entrusted confidential information. Tort liability in these cases ultimately finds justification in the important public policy of maintaining the integrity of market transactions.

II. The Tort Duty

At first blush, the existence of a tort duty would seem to be straightforward in data breach cases. An apt analogy is provided by traditional cases of bailment, in which the bailor gives possession of her tangible property to the bailee, thereby obligating the bailee to exercise reasonable care to protect that property.[19] The same substantive rationale for this tort duty extends to cases in which a customer has entrusted her intangible, confidential information to another in the course of a business transaction, thereby obligating the possessor to exercise reasonable care in protecting that valuable property.

The duty can also be easily justified by fundamental tort principles. For example, in a recent decision involving consolidated actions over data theft of confidential customer information, the court held that the existence of duty is "well supported by both common sense and . . . Massachusetts law."[20] In support of its decision, the court cited a Massachusetts case holding that "[a] basic principle of negligence law is that ordinarily everyone has a duty to refrain from affirmative acts that unreasonably expose others to a risk of harm."[21] These requirements are obviously satisfied for cases in which a business affirmatively collected a customer's confidential personal information and then failed to exercise reasonable care in protecting that entrusted information from theft, foreseeably causing injury to the customer.[22]

19. *See* Coggs v. Bernard, 92 Eng. Rep. 107 (Q.B. 1704) (adopting the six types of bailments and their associated standards of care as recognized by Roman law).

20. *In re* Sony Gaming Networks & Customer Data Sec. Breach Litig., 996 F. Supp. 2d 942, 966 (S.D. Cal. 2014) (ruling on consolidated action of certain civil actions across country that had been transferred to the court by the Judicial Panel on Multidistrict Litigation).

21. *Id.* (quoting Yakubowicz v. Paramount Pictures Corp., 536 N.E.2d 1067, 1070 (1989)).

22. *See also* Bell v. Mich. Council, No. 246684, 2005 WL 356306, at *5 (Mich. Ct. App. Feb. 15, 2005) (per curiam) (holding that the "defendant did owe plaintiffs a duty to protect them from identity theft by providing some safeguards to ensure the security of their most essential confidential identifying information"). *But see* Cooney v. Chi. Pub. Sch., 943 N.E.2d 23, 28–29 (Ill. App. Ct. 2010) ("Plaintiffs . . . contend that we should recognize a 'new common law duty' to safeguard information. They claim a duty is justified by the sensitive nature of personal data such as dates of birth and social security numbers. Plaintiffs do not cite to an Illinois case that supports this argument. While we do not minimize the importance of protecting this information, we do not believe that the creation of a new legal duty beyond legislative requirements already in place is part of our role on appellate review. . . . [T]he legislature has specifically addressed the issue and only required the [defendant] to provide notice of the disclosure.").

The same case, however, reveals the difficulties posed by such a duty. Plaintiffs had a contractual relationship with the defendant and sought tort recovery only for pure economic losses caused by the identify theft, such as the expense of purchasing credit-monitoring services.[23] As the court explained, "Massachusetts generally prohibits the recovery of purely economic losses in tort absent personal injury or property damage."[24] This prohibition—known as the economic loss rule—eliminates the tort obligation, because "a commercial user can protect himself by seeking express contractual assurances . . . or by obtaining insurance against losses."[25] Having first concluded that the tort duty under Massachusetts law is a matter of "common sense," the court then summarily negated that duty with the economic loss rule.

Although fundamental tort principles clearly establish that businesses owe a duty of reasonable care to protect the confidential information of their customers, for cases in which a breach of that duty causes only pure economic loss, the existence of that duty also depends on the contractually based economic loss rule. To evaluate the potential tort liabilities for data breaches, we need to consider how the associated tort duty is affected by the contractually based economic loss rule.

A. The Contractually Based Economic Loss Rule

In data breach cases, most identity theft victims only suffer economic loss caused by the failure of a business to protect their confidential information.[26] According to the *Restatement (Third) of Torts*, "there is no liability in tort for economic loss caused by negligence in the performance . . . of a contract between the parties."[27] The obligation incurred by a business to protect a customer's confidential information is entailed by their contractual relationship, apparently triggering the economic loss rule.

Even if the obligation to reasonably secure a customer's confidential information is not expressly written into the contract, it nevertheless is an implied contractual term for reasons well described by one court: "Ordinarily, a consumer does not expect—and certainly does

23. *Id.*

24. *In re Sony Gaming Networks*, 996 F. Supp. 2d at 967 & n.16 (quoting Bay State-Spray & Provincetown S.S., Inc. v. Caterpillar Tractor Co., 533 N.E.2d 1350, 1354–55 (Mass. 1989)).

25. *Id.*

26. *See supra* notes 3–5 and accompanying text. The issue of damages for emotional distress caused by the underlying threat of financial loss is discussed in Part IV.

27. RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 3 (AM. LAW INST. 2012).

not intend—the merchant to allow unauthorized third-parties to access that data. A jury could reasonably conclude, therefore, that an implicit agreement to safeguard the data is necessary to effectuate the contract."[28]

Because the obligation of a business to exercise reasonable care in protecting confidential customer information is an implied contractual term of the transaction, a tort claim based on the theft of such data is essentially alleging that the defendant business negligently performed the contract or otherwise impliedly misrepresented that it would take reasonable measures to protect that information. If the tort claim then seeks recovery only for the economic losses caused by the identity theft, the black-letter requirements of the economic loss rule are clearly satisfied: the parties are in a contractual relationship; the plaintiff customer alleges that the defendant business negligently performed the contract; and the plaintiff seeks tort recovery only for pure economic loss.[29] When applied in this manner, the economic loss rule bars the tort claim by negating any tort duty requiring businesses to exercise reasonable care to prevent third parties from gaining unauthorized access to confidential customer data.

This bar to recovery is not limited to negligence claims. In tort law, duty refers to the legal obligation owed by one party (the duty holder) to another (the right holder).[30] Without an antecedent legal obligation between the parties, there is no legal basis to impose tort liability on the defendant for the plaintiff's injuries.[31] Thus, "[i]t is fundamental that the existence of a legally cognizable duty is a prerequisite to all tort liability."[32] To be justifiable, a tort duty obligating a business to protect confidential customer information—whether based on negligence or any other tort cause of action, such as privacy—must be squared with the economic loss rule.

Although the black-letter formulation of the contractually based economic loss rule apparently bars tort recovery in these cases, the rule is more nuanced in application and requires further analysis. Tort law recognizes a cause of action for pure economic loss in a wide variety of cases, including "negligent misrepresentation, defamation, professional malpractice, breach of fiduciary duty, nuisance, loss of consor-

28. Anderson v. Hannaford Bros. Co., 659 F.3d 151, 159 (1st Cir. 2011).

29. RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 3 cmt. a.

30. Cippollone v. Liggett Group, Inc., 505 U.S. 504, 522 (1992).

31. *Id.*

32. Graff v. Beard, 858 S.W.2d 918, 919 (Tex. 1993); *see also Cippollone*, 505 U.S. at 522 (holding that "common-law damages actions of the sort raised by petitioner [involving strict products liability, negligence, express warranty and intentional tort claims] are premised on the existence of a legal duty").

tium, wrongful death, spoliation of evidence, and unreasonable failure to settle a claim within insurance policy limits."[33] Many of these claims involve parties who are in contractual relationships, yet plaintiffs recover tort damages for their pure economic losses, which is inconsistent with the black-letter formulation of the contractually based economic loss rule.[34] As one judge observed: "The inconsistent treatment of the doctrine by use of varying analytical frameworks, does not provide the bench and bar guidance in the proper application of the doctrine."[35] Consequently, courts have "underscore[d] the desirability—perhaps urgency—of harmonizing the entire complex and confusing pattern of liability and nonliability for tortious conduct in contractual settings."[36] The black-letter formulation of the economic loss rule has not sufficiently harmonized the entire body of case law, leading to the question of whether it provides adequate guidance for resolving the novel issues involved in cases of identity theft caused by the failure of a business to protect the confidential information of its customers.

The economic loss rule is vexing because it takes different forms that must be adequately distinguished. The contractually based economic loss rule differs from the economic loss rule that limits tort liability in noncontractual settings.[37] Despite this important difference, courts have not always identified which formulation they are relying on to resolve tort claims for identity theft.[38] Even when courts expressly invoke the contractually based economic loss rule, they are not always clear about which version of the rule they are applying.[39] The contractually based economic loss rule has been formulated in two distinct manners—one formal, the other substantive. The two versions of the rule sometimes yield opposite outcomes, making it necessary to recognize their differences.

To illustrate, consider how the formal and substantive versions of the contractually based economic loss rule apply to cases in which the parties are not in a contractual relationship or actual privity, but are instead situated in a web of contracts placing them in near privity. Because the formal (black-letter) version of the economic loss rule

33. Vincent R. Johnson, *The Boundary-Line Function of the Economic Loss Rule*, 66 WASH. & LEE L. REV. 523, 530–32 (2009) (footnotes omitted).

34. *Id.*

35. Sapp v. Ford Motor Co., 687 S.E.2d 47, 52 (S.C. 2009) (Beatty, J., concurring).

36. Rardin v. T & D Mach. Handling, Inc., 890 F.2d 24, 30 (7th Cir. 1989).

37. *See generally* Catherine M. Sharkey, *Can Data Breach Claims Survive the Economic Loss Rule?*, 66 DEPAUL L. REV. 339 (2017).

38. *See generally id.*

39. *See id.*

only bars the tort claim when it seeks to allocate liability for pure economic loss among contracting parties,[40] the rule does not bar tort claims in cases of near privity.[41] As a substantive matter, this result is troubling. A formal requirement of contractual privity does not adequately account for the gaps in privity that often occur within a series of interrelated, complex commercial contracts—like those involved in data breach cases.[42] Even if the tort plaintiff is not in privity with the defendant, the two parties can still be situated within a web of contracts that permit the plaintiff to adequately protect her interests through contracting with others. By relying on this type of substantive rationale, many courts have applied the contractually based economic loss rule to bar tort recovery for identity theft in cases of near privity, contrary to the formal or black-letter version of the economic loss rule.[43]

The formal version of the economic loss rule is also subject to varied exceptions,[44] leaving open the question of whether there is a more general substantive formulation that captures the relevant considerations across the full range of cases. Why does the rule bar tort recovery for pure economic loss in some cases but not others? The question can be resolved only by a substantive conception of the economic loss rule, not by a conception that is based wholly on the formal properties of the tort claim: Does it seek to allocate responsibility for pure economic loss among contracting parties?

B. The Substantive Contracting Rationale for the Economic Loss Rule

According to the *Restatement (Third) of Torts*, the contractually based economic loss rule "origin[ated] in cases that involve[d] products liability."[45] In product cases, a growing majority of courts have followed the approach charted by the U.S. Supreme Court in *East*

40. RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 3 (AM. LAW INST. 2012).

41. Banknorth, N.A. v. BJ's Wholesale Club, Inc., 394 F. Supp. 2d 283, 286–87 (D. Me. 2005).

42. *See id.* at 287 ("[T]he credit card industry involves a complex web of relationships involving numerous players governed by both individual contracts and exhaustive regulations promulgated by Visa and other card networks.").

43. *See* Annett Holdings, Inc. v. Kum & Go, L.C., 801 N.W.2d 499, 504 (Iowa 2011) ("When parties enter into a chain of contracts, even if the two parties at issue have not actually entered into an agreement with each other, courts have applied the 'contractual economic loss rule' to bar tort claims for economic loss, on the theory that tort law should not supplant a consensual network of contracts."). These cases are discussed at greater length in Sharkey, *supra* note 37.

44. RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 3.

45. *Id.* § 3 cmt. a.

River Steamship Corp. v. Transamerica Delavel Inc.,[46] which barred tort recovery for all stand-alone economic harms to ensure that contract law does not "drown in a sea of tort."[47] As the Court explained, "damage to a product itself has certain attributes of a products-liability claim. But the injury suffered—the failure of the product to function properly—is the essence of a warranty action through which a contracting party can seek to recoup the benefit of its bargain."[48] This contracting rationale has been regularly invoked by other courts, yielding a "high degree of agreement" that the economic loss rule bars tort recovery for pure economic loss in order to maintain the boundary between contract and tort law.[49] The *Restatement* then "generalizes" this rule so that it also bars tort claims for "economic injuries arising from the breach of other sorts of contracts."[50]

Although courts regularly limit the tort duty for these reasons, they have not rigorously analyzed or systematically developed the substantive contracting rationale for doing so. In a 2016 article written for the *21st Annual Clifford Symposium on Tort Law and Policy*, I showed that when the economic loss rule is justified by a substantive contracting rationale, the availability of tort recovery for pure economic losses depends on whether the ordinary consumer has the requisite information to protect the relevant set of interests by contracting.[51] This formulation justifies the general bar to recovery of pure economic loss in product cases as per the black-letter rule, but it also improves the rule by justifying the limited exceptions that have otherwise eluded satisfactory explanation in the case law.[52]

The logic of the substantive contracting rationale for the economic loss rule is evident in the *Restatement*.[53] For example, the *Restatement* permits tort recovery for pure economic loss in cases involving the

46. 476 U.S. 858 (1986).

47. *Id.* at 865–66.

48. *Id.* at 867–68.

49. Johnson, *supra* note 33, at 526.

50. RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 3 cmt. a (AM. LAW INST. 2012).

51. Mark A. Geistfeld, *The Contractually Based Economic Loss Rule in Tort Law: Endangered Consumers and the Error of* East River Steamship, 65 DEPAUL L. REV. 393 (2016) [hereinafter *Economic Loss Rule*].

52. *See id.* at 401–16 (showing how the substantive contracting rationale explains why courts permit tort recovery for pure economic loss in cases of asbestos abatement and medical monitoring—two important exceptions to the economic loss rule in product cases that courts have not otherwise squared with that rule).

53. *See, e.g.*, RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 3 cmt. c ("[T]he purpose of this Section is to protect the bargain the parties made, not to penalize the plaintiff for failing to make a broader one. Navigating between these points may require study of the transaction and its logic.").

negligent provision of professional services, recognizing that the exception critically depends on the criteria for determining whether the defendant supplied professional services:

> In defining which occupational groups are "professionals," courts consider whether the practice of the occupation requires formal training and a license issued by a public body, whether the occupation has an internal code of conduct and discipline, and whether there is a need for complex discretionary judgments in carrying out the work. *These are proxies for the policies that lie behind the rule of this Section* [*permitting tort recovery for pure economic loss caused by the negligent provision of professional services*]; *they suggest limits on the reliability of contract to effectively regulate the risks at stake*. Thus, licensing requirements demonstrate that the community expects due care of the practitioner apart from the duties imposed by contract. Requirements of formal training for the work mean that a client is not likely to understand the practitioner's methods well enough to negotiate over their use. Internal rules of conduct elicit an extra measure of trust from clients and suggest that the occupational group itself regards contract alone as an inadequate device for setting standards. And if the practitioner's work requires complex discretionary judgments, it will be hard to specify how they should be made. The client cannot simply make a contract for a particular result and then sue for breach if the result is not obtained.[54]

As these comments show, the ordinary client who does business with a "professional" does not have sufficient information to protect his or her economic interests by contracting over the "complex discretionary judgment in carrying out the work." The substantive contracting rationale for the economic loss rule does not apply, justifying an independent tort duty requiring the professional to exercise reasonable care in providing these services.

Whether the economic loss rule applies in any given case, therefore, does not solely depend on the formal properties of the parties' relationship and the damages claim. When justified by a substantive contracting rationale, the economic loss rule only eliminates the tort duty if the ordinary patient, client, or other type of customer has the information required to adequately protect her interests by contracting.

C. The Substantive Contracting Rationale in Data Breach Cases

Whether the substantive version of the economic loss rule applies in data breach cases depends on whether the ordinary customer has sufficient information to protect his or her confidential information by contracting with a business over the reasonable security of that data.

54. *Id.* § 4 cmt. b (emphasis added).

The issue is complex and outside the informed contracting capabilities of most customers. Due to the inadequacy of contracting, an independent tort obligation is required to ensure that businesses adopt reasonable measures for protecting confidential customer information.[55]

Consider a computer network utilized by a business. How is a customer supposed to evaluate the risk or degree to which the network is vulnerable to hacking and other types of cyberbreaches? The customer can assess the value of the confidential data in question, but that is not enough. The customer must also assess the software that protects the business's database from unauthorized access. "[T]he ability of most consumers to obtain information about code is limited and the information is not readily available," and so the ordinary customer usually cannot "assess the risks of the data plus code combination."[56]

Not only are customers unable to accurately assess the risk that their confidential information will be stolen from the business, but given the complexity of the assessment, they could easily forego consideration of the matter altogether, reasoning that the cost of evaluating a business's security measures vastly outweighs any potential benefits.[57] Moreover, customers repeatedly face the same problem as

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55. For extended analysis showing why uninformed consumer contracting decisions result in contracts that do not adequately protect consumer interests, see Geistfeld, *Economic Loss Rule*, *supra* note 51, at 397–401; Andrea M. Matwyshyn, *Privacy, the Hacker Way*, 87 S. CAL. L. REV. 1, 46 (2013) ("In consumer privacy contexts, commercially reasonable negotiated measures of information care and security are absent. Due to their non-negotiability, terms of use and privacy policies reflect an imbalance in favor of the drafter—the data aggregator—whose interests are not aligned with those of the consumer.").

56. Andrea M. Matwyshyn, *Hidden Engines of Destruction: The Reasonable Expectation of Code Safety and the Duty to Warn in Digital Products*, 62 FL. L. REV. 109, 120 (2010) (footnote omitted).

57. To be sure, some customers may have sufficient expertise or otherwise be willing to incur the costs of becoming informed about the data security measures adopted by a business. If enough customers are well informed, the business would have a sufficient financial incentive to provide reasonable data protection. This dynamic, however, actually exacerbates the informational problem and substantially strengthens the case for the tort duty, because the conduct of well-informed customers creates an information externality that benefits uninformed customers. As I have explained in a related context involving product safety,

> [t]his informational externality . . . reduces consumer incentives to acquire costly information in the first instance. When information is costly to acquire and process, any consumer may rationally decide to free ride on the informed choices of others, thereby saving the information costs. The consumer can get the benefits of information (safe products) without incurring the costs of acquiring and processing the information. Reasoning similarly, other consumers will make the same choice. The free-rider problem may result in no consumer incurring the costs necessary for making informed decisions about product safety.

Mark A. Geistfeld, *Products Liability*, *in* 1 ENCYCLOPEDIA OF LAW AND ECONOMICS 295 (Michael Faure ed., 2d ed. 2009) (citations omitted). By this same reasoning, each individual

they engage in myriad transactions with other businesses, often over the course of a single day. Who has the time, energy, and capacity to make an informed contractual decision over data security with each and every transacting party?

Recognizing the informational problem, the ordinary customer would instead want to contractually obligate the business to adopt reasonable security measures. *The solution to the contracting problem is no different from an independent tort duty requiring the business to exercise reasonable care.*

Like the tort duty governing the provision of professional services, the tort duty obligating businesses to protect confidential consumer information can be derived from a substantive contracting rationale. The contracting problem over the provision of professional services is not obviously any easier to solve than the contracting problem over data theft.[58] Each one is complex and outside the competence of the ordinary client or customer. As in the case of professional malpractice, the contracting problem for identify theft is better resolved by an independent tort duty requiring the exercise of reasonable care.

The independent tort duty obligating businesses to protect confidential consumer information finds further justification in public policy. In justifying the tort duty encompassing the pure economic losses caused by the negligent provision of professional services, the *Restatement* observes that "licensing requirements demonstrate that the community expects due care of the practitioner apart from the duties imposed by contract."[59] So, too, the public policy embodied in numerous statutes and regulations fully justifies a tort duty for businesses to protect confidential consumer data that is independent of any contractual obligation.

"[S]everal states have enacted laws imposing a general obligation on all companies to ensure the security of personal information,"[60] including California.[61] The statutory requirements also involve the

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customer can rationally decide not to become informed about the data security of a particular business, creating the informational problem that justifies the tort duty.

58. As the *Restatement* explains with respect to the provision of professional services: "if the practitioner's work requires complex discretionary judgments, it will be hard to specify how they should be made. The client cannot simply make a contract for a particular result and then sue for breach if the result is not obtained." RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 4 cmt. b.

59. *Id.*

60. Thomas J. Smedinghoff, An Overview of Data Security Legal Requirements for All Business Sectors 5 (Oct. 8, 2015) (unpublished manuscript), http://ssrn.com/abstract=2671323.

61. CAL. CIV. CODE § 1798.81.5 (West 1016).

obligation to disclose security breaches to the affected parties.[62] In addition, "[t]he obligation to provide adequate security for personal data collected, used, and/or maintained by a business is a critical component of almost all privacy laws. Most statements of basic privacy principles include security as a key component."[63] These obligations—to take reasonable security measures and to disclose any security breaches—are each implied by the contractual transaction between a business and its customers.[64] The obligations are contractual in the first instance, yet legislatures have also made them into independent legal obligations, thereby preventing businesses from disowning these responsibilities with contractual disclaimers and the like. These legislative requirements accordingly "demonstrate that the community expects due care of the [business to protect confidential consumer information] apart from the duties imposed by contract,"[65] the same rationale for subjecting the providers of professional services to a tort duty that is independent of their contractual obligations.

To be sure, these statutes do not create a tort cause of action for identity theft, but they still justify the common-law duty. For reasons of institutional comity, courts exercise common-law discretion by deferring to a nonbinding legislative policy determination that is relevant to the resolution of a tort claim.[66] Pursuant to this principle of deference, if a statute or administrative regulation is based on a policy decision that is relevant to any issue posed by the common-law duty question, courts will defer to that policy decision. Consequently, if a regulation or statute resolves a policy issue that courts had previously relied upon to reject the duty, then deference to this particular legislative policy determination would enable courts to recognize a new duty.[67] In this respect, a state regulation or statute can justify a new common-law tort duty, even if there is no statutory purpose to create a new form of tort liability.[68]

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62. Smedinghoff, *supra* note 60, at 6 ("A total of 46 states in the U.S., plus the District of Columbia, Puerto Rico, and the Virgin Islands, have enacted security breach notification laws . . . .").

63. *Id.* at 5.

64. *See supra* note 28 and accompanying text.

65. RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 4 cmt. b (AM. LAW INST. 2012).

66. *See* Mark A. Geistfeld, *Tort Law in the Age of Statutes*, 99 IOWA L. REV. 957, 976–83 (2014) [hereinafter *Age of Statutes*].

67. *See id*. at 977–83.

68. *See* RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR PHYSICAL AND EMOTIONAL HARM § 14 cmt. i (AM. LAW INST. 2010) (explaining that the violation of a statute is relevant to duty analysis and can lead courts to recognize a duty that they would not otherwise recognize absent the statute).

When courts invoke the contractually based economic loss rule to bar tort recovery for identity theft, their decisions are based on the policy judgment that customers can adequately protect their interests by contracting.[69] The identical policy issue is addressed by regulations and statutes that require businesses to adequately protect confidential customer information. As these regulations and statutes clearly show, legislatures have concluded that contracting does not sufficiently protect against data theft. By deferring to this legislative policy judgment, courts can conclude that the substantive contracting rationale for negating the tort duty with the economic loss rule does not apply in cases of identity theft.[70]

More generally, one can persuasively argue that the law of fiduciary relationships can be defensibly extended to recognize a new category of "information fiduciaries."[71] For present purposes, however, the argument is more straightforward. Identity theft involves an issue of public policy that is not adequately addressed by the private ordering of contracts—the domain protected by the economic loss rule. In the Information Age, the integrity of the marketplace depends on the adequate protection of the confidential consumer information that has become a necessary component of business transactions.[72] Instead of exclusively relying on contracts to address this important issue, federal and state legislation has sought to bolster the integrity of the market by making data security an independent obligation owed by businesses to their customers. By recognizing this public policy, courts can justify a common-law duty for businesses to exercise reasonable care in the protection of confidential customer information. Public policy ultimately supplies the strongest argument for a tort duty not limited by the economic loss rule in cases of identity theft.[73]

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69. *See supra* Part II.B.

70. To be sure, the widespread statutory regulation could evince a legislative purpose that might be undermined by additional tort regulation, but if so, the statutory scheme would preempt the common-law tort claim. *See* Geistfeld, *Age of Statutes*, *supra* note 66, at 1004–09. Unless tort claims are expressly or impliedly preempted by the statutes in question, courts can defer to the underlying legislative policy judgment that cases of identity theft are not adequately regulated by the private ordering of contracts, justifying a tort duty for reasons given in the text above.

71. *See* Jack M. Balkin, *Information Fiduciaries and the First Amendment*, 49 U.C. DAVIS L. REV. 1183, 1205–09 (2016). *But see* Anderson v. Hannaford Bros. Co., 659 F.3d 151, 157–58 (1st Cir. 2011) (rejecting plaintiffs' claim that defendant retailer owed them a fiduciary duty to protect their credit and debit card data).

72. *See supra* notes 1–2 and accompanying text.

73. Indeed, the integrity of the market provides a rationale for another important exception to the economic loss rule. *See* RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR ECONOMIC HARM § 3 cmt. d (AM. LAW INST. 2012) ("Fraudulent inducement to enter a contract, unlike a claim of negligent misrepresentation, can in some circumstances give a plaintiff a viable tort claim. When

III. Negligence or Strict Liability?

A tort duty to exercise reasonable care directly translates into the rule of negligence liability, but it can also justify a rule of strict liability. As before, the tort rules governing liability for defective products provide relevant guidance.

Strict products liability is a body of law that contains important rules of negligence liability—most notably, the risk-utility test for determining whether a product has a defective design or warning—but strict liability applies to products that malfunction, often due to construction or manufacturing defects.[74] The varied rules of negligence and strict liability are rendered into a coherent body of law by the manner in which the duty to exercise reasonable care justifies the limited rules of strict liability.[75] The same reasoning applies to cases of identity theft.

In order to effectuate the transaction, a business impliedly represents that it will exercise reasonable care in the protection of a customer's confidential data.[76] Based on this implied representation, one court rejected a claim for strict liability:

> A jury could reasonably find that customers would not tender cards to merchants who undertook zero obligation to protect customers' electronic data. But in today's known world of sophisticated hackers, data theft, software glitches, and computer viruses, a jury could not reasonably find an implied merchant commitment against every intrusion *under any circumstances whatsoever* (consider, for example, an armed robber confronting the merchant's computer systems personnel at gunpoint). Thus, . . . a jury could not reasonably find that an unqualified guaranty of confidentiality by the merchant is "absolutely essential" to the contract for a sale of groceries (there is

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two parties negotiate over a contract, the amount of care they are expected to show for each other's interests will often be unclear or significantly less than the care expected in a situation involving strangers or the risk of physical injury. That is among the reasons why the duties of care between parties who negotiate contracts are not governed by the law of tort. Expectations of honesty are more regular, however, and the disappointment of them may call for remedies not customarily available from the law of contract or restitution. Liability in tort may therefore be recognized in such circumstances."); *see also* Dan B. Dobbs et al., Hornbook on Torts § 41.9 (2d ed. 2016) (arguing that "the existence of a contract duty does not preclude construction of a tort duty where considerations of justice and policy warrant liability" and concluding that this "is true even in pure economic loss cases, as the attorney example [of legal malpractice] shows").

74. *See* Restatement (Third) of Torts: Products Liability §§ 2–3 (Am. Law Inst. 1997).

75. *See generally* Mark A. Geistfeld, Products Liability Law 45–61 (2012) (showing how courts defensibly relied on the tort duty of reasonable care to justify the rule of strict liability for malfunctioning products).

76. *See supra* note 28 and accompanying text.

> no reason to believe that consumers would cease using their cards in the absence of a 100% guaranty of data safety).[77]

The problem with this reasoning is that it applies with equal force to the realm of product quality, and yet defects that cause a product to malfunction are subject to strict liability. To see why, consider the paradigmatic case of a soda bottle that explodes and causes injury to the consumer—the fact pattern that spawned the modern rule of strict products liability along with the contaminated food cases.[78]

Why does the exploding soda bottle frustrate consumer expectations, subjecting the seller to strict liability? Consumers know that perfect quality control is prohibitively expensive if not impossible. Despite the best inspection or manufacturing procedures, some defective soda bottles (and some contaminated food) will be distributed in the market. The risk of defect is unavoidable. Instead of expecting perfection, the ordinary consumer only expects that the soda bottle (or food) has passed reasonably safe, though imperfect, tests of quality control. For an exploding soda bottle to frustrate consumer expectations, the product performance must be attributable to the manufacturer's failure to exercise reasonable care in quality control. Consumer expectations accordingly justify a tort rule no different from ordinary negligence liability for the same reasons that the equivalent expectation of reasonably safe design justifies the negligence-based, risk-utility test.[79] What, then, justifies the rule of strict liability for the exploding soda bottle?

The rationale for strict liability is based on the difficulty of adequately enforcing the manufacturer's obligation to adopt reasonable quality-control measures. What is the full range of reasonably safe measures that a manufacturer could adopt to ensure the quality of a mass-manufactured product like bottled soda? The various measures are either complex (the incorporation of quality-control systems into the manufacturing process) or often cannot be proven with reliable evidence (as with visual inspection by employees). The expectation of

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77. *In re* Hannaford Bros. Co. Customer Data Sec. Breach Litig., 613 F. Supp. 2d 108, 119 (D. Me. 2009), *aff'd in part*, *rev'd in part*, Anderson v. Hannaford Bros. Co., 659 F.3d 151 (1st Cir. 2011) (holding that the relationship between a grocer and customer is not a confidential relationship).

78. In *Escola v. Coca Cola Bottling Co.*, the concurrence by Justice Traynor argued for the rule of strict liability that was ultimately widely adopted by other courts. 150 P.2d 436, 461 (Cal. 1944) (Traynor, J., concurring); *see* Mark Geistfeld, Escola v. Coca Cola Bottling Co.*: Strict Products Liability Unbound*, *in* TORTS STORIES 229, 234–39 (Robert L. Rabin & Stephen D. Sugarman eds., 2003).

79. *See* MARK A. GEISTFELD, PRINCIPLES OF PRODUCTS LIABILITY 37–43 (2d ed. 2011) (explaining why the ordinary consumer reasonably expects manufacturers to make cost-effective safety investments).

reasonable quality control, therefore, generates important safety obligations that cannot be adequately enforced by the consumer.[80] A manufacturer that does not take such a required precaution will avoid negligence liability,[81] impairing its financial incentives to incur this costly safety investment in quality control. Due to the cost and difficulty of enforcement, the negligence rule does not adequately protect the consumer's expectation that the manufacturer will employ reasonable quality-control measures.

To solve this evidentiary problem and thereby enforce the expectation of reasonable quality control, the ordinary consumer can reasonably expect the manufacturer to guarantee that the soda bottle will not explode or is otherwise fit for its intended purpose—a rule of strict liability. As Oliver Wendell Holmes explained, "the safest way to secure care is to throw the risk upon the person who decides what precautions shall be taken."[82] Once a manufacturer becomes strictly liable for injuries caused by a defective product, the court no longer needs to rely on the plaintiff's proof to evaluate the manufacturer's safety decisions. Strict liability "throws" that decision on the manufacturer, restoring its financial incentive to exercise reasonable care.

In deciding how to proceed, a manufacturer subject to strict liability will rationally try to minimize its total costs. The manufacturer understands that it will be liable for the compensable injuries suffered by consumers. These liability costs depend upon the probability that an injury will occur (denoted P) and the total amount of damages or loss caused by the injury (denoted L). Multiplying these two factors together yields the manufacturer's expected liability costs (PL). The manufacturer can reduce the expected liability costs by improving safety and decreasing the likelihood of product-caused injury. Ordinarily, such a safety precaution imposes a cost or burden on the manufacturer (denoted B). A strictly liable manufacturer, therefore, will rationally compare the burden (B) of a safety precaution to the expected liability costs that it would otherwise incur by not taking the precaution and eliminating this risk (PL). To minimize costs, the

80. *See Escola*, 150 P.2d at 439.

81. As one court observed:

> It is not doubted that due care might require the defendant to adopt some device that would afford [reasonable] protection against [the injury suffered by plaintiff.] Such a device, if it exists, is not disclosed by the record. The burden was upon the plaintiff to show its practicability. Since the burden was not sustained, a verdict should have been directed for the defendant.

Cooley v. Pub. Serv. Co., 10 A.2d 673, 677 (N.H. 1940).

82. OLIVER WENDELL HOLMES, JR., THE COMMON LAW 117 (1881).

manufacturer will take any precaution costing less than the expected liability costs it would otherwise incur:

$$B < PL$$

Now consider the precautions required by the negligence standard of reasonable care. According to the *Restatement (Second) of Torts*, the standard of reasonable care requires a determination of "whether the magnitude of the risk outweighs the value which the law attaches to the conduct which involves it."[83] One form of this determination is captured by Judge Learned Hand's well-known formulation of the negligence standard: "if the probability [of injury] be called *P*; the injury, *L*; and the burden [of a precaution that would eliminate this risk] *B*; liability depends upon whether *B* is less than *L* multiplied by *P*: i.e., whether $B < PL$."[84] This standard of reasonable care not only satisfies the ordinary consumer's reasonable expectations of product safety, it also requires the same safety precautions that would be chosen by a strictly liable manufacturer.

Insofar as the manufacturer would have foregone any of these safety investments in a negligence regime due to problems of proof, the shift to strict liability will increase manufacturer investments in product safety and reduce product risk.[85] The evidentiary difficulties inherent in negligence liability, therefore, can justify strict liability as a means for enforcing the duty to exercise reasonable care.

Modern courts invoked this reasoning to justify the ancient rule of strict liability for the sale of contaminated food.[86] These cases subsequently influenced others, like those involving exploding bottles of

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83. RESTATEMENT (SECOND) OF TORTS § 283 cmt. e (AM. LAW INST. 1965).

84. United States v. Carroll Towing Co., 159 F.2d 169, 173 (2d Cir. 1947) (emphasis added).

85. *See* Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1, 2–3, 23 (1980) (showing how strict liability can reduce risk by reducing "activity" levels, where "activity" is any aspect of risky behavior that is outside the ambit of negligence liability due to evidentiary limitations).

86. In tort cases involving the sale of contaminated food, as the Texas Supreme Court observed, "a rule which would require proof of negligence as a basis of recovery would, in most instances, by reason of the difficulty of making such proof, be equivalent to a denial of recovery." Jacob E. Decker & Sons v. Capps, 164 S.W.2d 828, 834 (Tex. 1942). After discussing the difficulties faced by a plaintiff in trying to prove that a defendant failed to exercise reasonable care in distributing contaminated food, the court concluded that these evidentiary difficulties justified a rule of strict liability:

> Such a rule would seem to be more desirable because it permits the placing of the ultimate loss upon the manufacturer, who is in the best position to prevent the production and sale of unwholesome food. It stimulates and induces a greater degree of precaution for the protection of human life and health than does the rule of ordinary care.

Id.

soda.[87] This case law was then restated into the rule of strict products liability.[88] As the *Restatement (Third) of Torts* explains, strict liability applies to manufacturing defects—the reason why the food was contaminated or the soda bottle exploded—because the liability serves an "instrumental function of creating safety incentives" greater than those in a negligence regime, "under which, as a practical matter, sellers may escape their appropriate share of liability."[89]

This evidentiary rationale for strict liability has long been recognized by courts in other types of cases. According to a nineteenth century torts treatise, "the ground on which a rule of strict obligation has been maintained and consolidated by modern authorities is the magnitude of danger, coupled with the difficulty of proving negligence as the specific cause, in the particular event of the danger having ripened into actual harm."[90] This reasoning, for example, can justify the rule of strict liability for abnormally dangerous activities.[91] Indeed, the evidentiary rationale for strict liability provided an important justification for the statutory schemes of workers' compensation that were widely adopted by the states in the early 1900s.[92]

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87. As Justice Traynor observed in his influential concurrence arguing for strict products liability, a negligence regime does not adequately solve the safety problem, because "[a]n injured person . . . is not ordinarily in a position to refute [the manufacturer's evidence of reasonable care] or identify the cause of the defect, for he can hardly be family with the manufacturing process as the manufacturer himself is." Escola v. Coca Cola Bottling Co., 150 P.2d 436, 441 (Cal. 1944) (Traynor, J., concurring).

88. *See* RESTATEMENT (SECOND) OF TORTS § 402A cmt. b (discussing how the rule of strict products liability evolved from the sale of contaminated or "corrupt" food and drink).

89. RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 2 cmt. a (AM. LAW INST. 1997).

90. FREDERICK POLLOCK, THE LAW OF TORTS: A TREATISE ON THE PRINCIPLES OF OBLIGATIONS ARISING FROM CIVIL WRONGS IN THE COMMON LAW 307 (1st ed. 1887).

91. *See* Ind. Harbor Belt R.R. Co. v. Am. Cyanamid Co., 916 F.2d 1174, 1177 (7th Cir. 1990). For more extensive discussion, see Mark Geistfeld, *Should Enterprise Liability Replace the Rule of Strict Liability for Abnormally Dangerous Activities?*, 45 UCLA L. REV. 611 (1998). For extended argument that the logic of strict liability for abnormally dangerous activities applies to cases of identity theft, see Citron, *supra* note 3. That rule, however, does not apply in contractual settings. *See* RESTATEMENT (THIRD) OF TORTS: LIABILITY FOR PHYSICAL AND EMOTIONAL HARM § 24(a) (AM. LAW INST. 2010) (stating that an otherwise abnormally dangerous activity is not subject to strict liability if "the person suffers physical or emotional harm as a result of making contact with or coming into proximity to the defendant's . . . abnormally dangerous activity *for the purpose of securing some benefit* from that contact or that proximity" (emphasis added)). In contractual settings, the plaintiff comes into "contact" with the defendant's activity of supplying the service or product in question in order to derive the benefit from that service or transaction, barring application of strict liability on the ground that it is an abnormally dangerous activity. *See id*. § 24 cmt. a (explaining why strict liability does not govern claims made by airline passengers for plane crashes, or "if at the plaintiff's request the defendant blasts on the plaintiff's land, or if the defendant treats the plaintiff's home with an insecticide").

92. According to the U.S. Supreme Court:

> In support of the legislation, it is said that the whole common-law doctrine of employer's liability for negligence, with its defenses of contributory negligence, fellow ser-

The same rationale for strict liability applies to the tort duty requiring businesses to exercise reasonable care for protecting confidential consumer information. Complicated computer programs protect businesses from unauthorized access to their computer systems. The system itself involves six different elements, each of which makes the system vulnerable to unauthorized access.[93] Given the complex interrelationships, how can the ordinary consumer prove that the business did not have a reasonably secure system? Moreover, "[c]yber-intruders employ increasingly innovative techniques to bypass security measures and steal personal data, thereby requiring an ever-changing information-security response to new threats, vulnerabilities, and technologies."[94] Measures that were once reasonable can quickly become outdated, eliminating the efficacy of custom as a measure of reasonable care—a suspect form of proof in any event.[95] Plaintiffs who were victims of identity theft would have to prove what reasonable care requires within a technologically complex and constantly evolving environment, an evidentiary burden comparable to, if not greater than, the burden faced by a consumer trying to prove that a product manufacturer failed to adopt reasonable quality-control measures.

Data breaches can also occur due to lapses by the employees of a business, but that same behavior can result in defective products (as in the preparation of contaminated food). The proof in these cases is not difficult because of the complexity of the safety decision, but rather because it typically depends on testimony by the employees. Were the proper procedures followed? Was attention being paid? The unreliable nature of this proof can also justify a rule of strict liability.

> vant's negligence, and assumption of risk, is based upon fictions, and is inapplicable to modern conditions of employment; that in the highly organized and hazardous industries of the present day the causes of accident are often so obscure and complex that in a material proportion of cases it is impossible by any method correctly to ascertain the facts necessary to form an accurate judgment, and in a still larger proportion the expense and delay required for such ascertainment amount in effect to a defeat of justice; that, under the present system, the injured workman is left to bear the greater part of industrial accident loss, which because of his limited income, he is unable to sustain, so that he and those dependent upon him are overcome by poverty and frequently become a burden upon public or private charity; and that litigation is unduly costly and tedious, encouraging corrupt practices and arousing antagonisms between employers and employees.

N.Y. Cent. R.R. Co. v. White, 243 U.S. 188, 197 (1917).

93. *See* Matwyshyn, *Hidden Engines of Destruction*, *supra* note 56, at 115–18.

94. Citron, *supra* note 3, at 264 (footnotes omitted).

95. *See* GEISTFELD, PRINCIPLES OF PRODUCTS LIABILITY, *supra* note 79, at 112–14 (explaining why courts have rejected customary safety practices as proof of reasonable care in product cases).

For example, courts relied on this reasoning to justify the early common-law rule that subjected common carriers, like railroads, to strict liability for losing the baggage of customers. As one court explained,

> What is the reason that the common law will not excuse the carrier unless he show the act of God, or the enemies of the Republic, or the misconduct of the plaintiff? . . . As late as 1828, in *Riley* v. *Horne*, Best, *Ch. J.*, said: "If the goods should be lost or injured by the grossest negligence of the carrier or his servants, or stolen by them or by thieves in collusion with them, the owner would be unable to prove either of these causes of loss: his witnesses must be the carrier's servants, and they, knowing that they could not be contradicted, would excuse their masters and themselves."[96]

Once again, this reasoning also applies to identify theft. Whether the property (luggage or personal data) is supposed to be secured by a common carrier or a retailer, an employee's failure to protect that property poses the same evidentiary problems. How often could a plaintiff credibly prove that the employee was at fault? After all, "his witnesses must be the [business's] servants, and they, knowing that they could not be contradicted, would excuse their masters and themselves."[97] Rather than rely on an employee's unreliable testimony, courts can instead impose strict liability on the business responsible for the identity theft.

To be sure, negligence can be easy to prove in some cases. For example, the defendants in two recent high-profile cases of identity theft presumably acted negligently by disregarding internal protocols or industry standards.[98] The issue, however, is not whether proof of negligence is easy in some cases. The true question is whether identity theft is likely to involve difficulties of proving negligence across the entire category of cases. The evolving complexity of the problem and the associated technological responses make it exceedingly difficult to adequately regulate this category of cases with negligence liability, justifying a rule of strict liability.

Like the element of duty, the substantive standard of strict liability ultimately finds its strongest support in the important public policy of maintaining the integrity of markets. The integrity of product markets critically depends on the ability of consumers to rely on product quality, a concern that first found expression in the ancient rule imposing

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96. Cole v. Goodwin & Story, 19 Wend. 250, 270 (N.Y. Sup. Ct. 1838) (citations omitted).

97. *Id.*

98. *See* Robert L. Rabin, *Perspectives on Privacy, Data Security and Tort Law*, 66 DEPAUL L. REV. 313, 315–16 (2017) (discussing security lapses by the retailer Target and the U.S. Government resulting in widespread identity theft).

strict liability on the sale of contaminated food.[99] In the same way that the logic of this rule fostered the development of strict products liability, it also justifies a rule of strict liability for protecting the confidential information that customers entrust to others in business transactions. In both instances, the protection afforded by negligence liability is inadequate due to difficulties of proof, requiring a rule of strict liability to enforce those obligations that are necessary for maintaining the integrity of the marketplace.

IV. DAMAGES

Identity theft can cause a variety of harms, as illustrated by the damages sought by class members in *Anderson v. Hannaford Brothers Co.*,[100] which included the cost of credit-monitoring services, unauthorized third-party credit-card charges that had been reversed by the issuing bank, various fees, lost reward points, "emotional distress, and time and effort spent reversing unauthorized charges and protecting against further fraud."[101] After concluding that the economic loss rule is limited to product cases and does not bar negligence claims for identity theft,[102] the district court dismissed these claims for each plaintiff (except one) on the ground that the damages were not cognizable under Maine's governing state law.[103] As this ruling shows, even if identity theft victims survive the bar posed by the economic loss rule, they still face considerable difficulties once the analysis turns to the element of damages.

First, consider the question of whether the plaintiff must actually incur unauthorized charges to her credit card in order to recover. In *Hannaford Brothers*, the federal appellate court held that the theft of a plaintiff's confidential information makes it reasonable to monitor her credit reports for fraudulent activity, justifying tort recovery for this expense of mitigating the loss.[104] The court's holding was based on the doctrine of avoidable consequences (discussed below), which further illustrates why the tort duty permits recovery for certain types

99. *See supra* note 88 and accompanying text.

100. 659 F.3d 151 (1st Cir. 2011)

101. *Id*. at 155.

102. *In re* Hannaford Bros. Co. Customer Data Sec. Breach Litig., 613 F. Supp. 2d 108, 126–28 (D. Me. 2009), *aff'd in part*, *rev'd in part*, *Anderson*, 659 F.3d at 151 (holding that grocery store customers had a cognizable injury through identity theft, as required for a cause of action for negligence and breach of contract against a grocer).

103. *Id.* at 131–35. The only remaining plaintiff sought damages for the financial loss of fraudulent charges that were not subsequently reimbursed by the bank that had issued the credit card. *Id.* at 133.

104. *Hannaford Bros.*, 659 F.3d at 163–64.

of pure economic loss. For example, one who faces a risk of cancer due to the defendant's tortious conduct can recover for the reasonable costs of medical monitoring, regardless of whether she ultimately gets cancer.[105] The same principle of mitigating future harms applies to the recovery of the fees for credit-monitoring services. To recover for the reasonable costs of purchasing credit-monitoring services, a plaintiff need not actually incur the costs of unauthorized transactions.

As in *Hannaford Brothers*, those identity theft victims who incur unauthorized charges to their credit cards or bank accounts often do not have to pay for them, as these charges are routinely reversed or the losses otherwise reimbursed by the financial institution in question.[106] Nevertheless, the unauthorized charge can still constitute a compensable form of economic loss for these victims. A bank that reimburses a plaintiff for unauthorized charges would have a subrogation right to any tort damages that the plaintiff receives for the loss.[107] The subrogation action makes the bank whole, ensures that the plaintiff is not doubly compensated for the identity theft, and places the ultimate loss on the party responsible for the loss in the first instance—the business that enabled a third party to steal the plaintiff's confidential information.[108] The reimbursement of unauthorized charges by a third party should not foreclose the victim of identity theft from recovering tort damages for those charges.

A more difficult issue involves damage claims for the time and effort to reverse unauthorized charges and protect against further fraud. In *Hannaford Brothers*, plaintiffs based their claim for recovery of these costs on the doctrine of avoidable consequences or mitigation of damages.[109] A clear statement of this doctrine is provided by the *Restatement (Second) of Torts*: "One whose legally protected interests have been endangered by the tortious conduct of another is entitled to recover for expenditures reasonably made . . . to avert the harm threatened."[110] To determine whether this doctrine permitted plain-

105. Recovery for these claims is permitted in about one-half of the jurisdictions that have addressed the matter. *See* Geistfeld, *Economic Loss Rule*, *supra* note 51, at 419–22. The courts that have rejected these claims, however, do not invoke the economic loss rule but instead rely on concerns such as fraud and administrability that are not relevant for present purposes. *See id*. (arguing that medical monitoring is an important exception to the economic loss rule).

106. *See, e.g.*, Banknorth, N.A. v. BJ's Wholesale Club, Inc., 394 F. Supp. 2d 283, 288 (D. Me. 2005) (discussing plaintiff bank's "averment that it reimbursed its customers for all amounts lost by them as a result of Defendants' conduct").

107. *See, e.g.*, *id*. at 287–88 (discussing doctrine of equitable subrogation).

108. *Id.*

109. *In re* Hannaford Bros. Co. Customer Data Sec. Breach Litig., 4 A.3d 492, 496–97 (Me. 2010).

110. RESTATEMENT (SECOND) OF TORTS § 919(1) (AM. LAW INST. 1979).

tiffs to recover for their lost time and effort, the federal district court in *Hannaford Brothers* certified the question to the Supreme Judicial Court of Maine, which concluded that the damages are not recoverable under Maine law: "Unless the plaintiffs' loss of time reflects a corresponding loss of earnings or earning opportunities, it is not a cognizable injury under Maine law of negligence."[111]

The court justified this conclusion in part on the ground that tort law does not permit recovery for "an inconvenience or annoyance,"[112] but its primary rationale was based on the difficulty of measuring the loss.[113] Recognizing that courts in other jurisdictions have permitted recovery for time and effort independent of lost earnings or earning capacity, the court concluded that these cases had "little bearing on [its] analysis" because "a passing mention of loss of time without adequate facts to demonstrate how those damages were being measured is insufficient to persuade us that the expenditure of time and effort alone is a harm recoverable in negligence."[114]

The threshold question posed by this ruling is whether tort damages are available for "an inconvenience or annoyance."[115] The general bar to tort recovery for this type of harm is most clearly embodied in the "live and let live" principle of nuisance law: "[P]eople who live in organized communities must of necessity suffer some inconvenience and annoyance from their neighbors and must submit to annoyances consequent upon the *reasonable* use of property by others."[116] The emphasis on "reasonable" is in the original quote and applies with full force to the issue under present consideration, which involves a claim of strict liability for identity theft. A strictly liable defendant has presumptively acted reasonably unless the evidence shows otherwise (in which case the plaintiff recovers under negligence). Absent such evidence, the defendant for legal purposes has acted reasonably, precluding an identity theft victim from recovering for mere annoyance and inconvenience.

Any identity theft victim will spend time getting new credit cards and the like, but for many of these individuals, only a few hours are required. For example, a DOJ study found that half of all identity

111. *In re Hannaford Bros.*, 4 A.3d at 492, 497.

112. *Id.* at 497.

113. *Id.* at 496 (observing that a plaintiff can receive tort damages for lost time when it results in a loss of earnings or earnings capacity, but "the time in question [can] be assigned a value reflecting" these losses).

114. *Id.* at 497.

115. *See supra* note 112 and accompanying text.

116. O'Cain v. O'Cain, 473 S.E.2d 460, 466 (S.C. Ct. App. 1996). The rule was famously expressed in Baron Bramwell's opinion in Bamford v. Turnley [1862] 122 Eng. Rep. 127 (Ex.).

theft victims in 2014 spent a day or less to address the problem.[117] For these victims, the lost time is an inconvenience or annoyance that is not compensable in tort.

As previously discussed, however, some victims of identity theft suffer a substantial loss of time. According to the DOJ study, "about 9%" of victims who were able to resolve the financial and credit problems caused by the identity theft in 2014 "spent more than a month" doing so.[118] This is hardly a mere annoyance or inconvenience.

For this class of plaintiffs, the amount of damages for lost time depends on how they frame the damages claim. In the *Hannaford Brothers* case, the Supreme Judicial Court of Maine held that lost time is a compensable economic harm only if it corresponds to an ascertainable market value.[119] The time in question involves efforts to correct unauthorized charges, establish new accounts, and clear the victim's credit record. All of these services are supplied by commercial firms that provide insurance to the victims of identity theft.[120] The cost that such a firm would charge the plaintiff to rectify her situation, therefore, would provide the requisite measure of market value that a plaintiff could rely on to quantify the economic loss for lost time caused by the identity theft.

Alternatively, these plaintiffs could frame the damages claim as a form of nonmonetary injury. In the class of cases under consideration, each plaintiff was forced to spend considerable time mitigating damages for which the defendant is responsible. Insofar as these efforts are significantly less enjoyable for the plaintiff than the alternative ways she could have used that time, the plaintiff has suffered a significant loss of life's pleasures—a compensable form of pain and suffering.[121] To be sure, these damages are hard to measure, but that does not prevent plaintiffs from recovery (as in cases involving bodily injury and the like). As courts have widely recognized, it would be "a perversion of fundamental principles of justice" if the uncertainty created by the defendant's tortious misconduct were to bar the plaintiff

117. *See* HARRELL, *supra* note 4, at 1.

118. *Id.* at 10.

119. *In re Hannaford Bros.*, 4 A.3d at 496–97.

120. *See Identity Theft Insurance*, INS. INFO. INST., http://www.iii.org/article/identity-theft-insurance (last visited Aug. 15, 2016) ("Some companies . . . offer restoration or resolution services that will guide you through the process of recovering your identity.").

121. *See* DOBBS ET AL., *supra* note 73, § 34.1 ("Any form of unpleasant emotional reactions to the injury or its consequences, so long as it is proximately related to the tort, can be a basis for the pain and suffering recovery.").

from recovering damages.[122] To avoid this injustice, tort law reduces the plaintiff's burden of proof in the damages phase of the case. The plaintiff is only required to establish the amount of damages with "as much certainty as the nature of the tort and the circumstances permit."[123] The difficulty of measuring the noneconomic injury of lost time, therefore, does not necessarily foreclose identity theft victims from recovering damages for the associated loss of life's pleasures.

The more difficult question is whether *any* damages for noneconomic harms should be available in cases of identity theft. Courts "remain deeply concerned to impose limitations" on recovery for pure emotional distress, with most requiring that "the plaintiff in fact suffered severe distress."[124] Moreover, there is some case law in support of the proposition that because damages for emotional harm "are usually rejected in breach of contract claims," by analogy, "recovery of emotional distress damages . . . for infliction of a purely financial tort, where there is no physical harm risk or caused, may be inappropriate."[125]

In the context of identity theft, the analogy to contract law is inapposite. Damages for emotional distress are not available under contract law because that type of harm is not a foreseeable consequence of the breached contract. Identity theft is different from the breach of contract in an ordinary commercial transaction. The relevant analogy is to insurance law, which enables policyholders to sue in tort and recover compensatory damages for emotional distress proximately caused by the insurer's bad-faith breach of the insurance contract.[126] The wrongful denial of an insurance claim predictably places the policyholder in financial stress with the associated anxieties—the same situation faced by the victim of identity theft. Emotional distress is a foreseeable consequence of breaching the duty to protect confidential consumer information.

Moreover, the emotional distress is proximately caused by an underlying compensable injury—the financial harms already incurred by the plaintiff and the ongoing need to mitigate those damages moving forward. As a matter of basic tort law, a plaintiff can recover for the foreseeable nonmonetary injuries that were proximately caused by a predicate compensable harm (as in the ordinary case of nonmonetary harms proximately caused by a predicate physical harm). Plaintiffs

122. Story Parchment Co. v. Paterson Parchment Paper Co., 282 U.S. 555, 563 (1931).
123. RESTATEMENT (SECOND) OF TORTS § 912 (AM. LAW INST. 1979).
124. DOBBS ET AL., *supra* note 73, § 29.9.
125. *Id.* § 29.1.
126. *See, e.g.*, Crisci v. Sec. Ins. Co., 426 P.2d 173, 178–79 (Cal. 1967).

who have already established a right to recover some compensatory damages, therefore, should be entitled to additional damages for the nonmonetary injuries involving lost time and the ensuing emotional distress, but only if these harms are more than a minor annoyance or inconvenience.

The important forms of damages caused by identity theft—the cost of credit-monitoring services and the like, unauthorized charges, and any significant loss of time and emotional distress—are all compensable as a matter of basic tort principles. Insofar as other types of economic loss (like lost reward points) are substantively similar, they are also compensable. Proof of compensable loss should not preclude these victims of identity theft from recovering against the defendant business that enabled a third party to steal their entrusted confidential information.

V. Conclusion

Identity theft does not readily fit into any of the traditional tort causes of action, explaining why the victims of identity theft have relied on a variety of tort claims to obtain recovery.[127] Based on established tort principles, customers who have been victimized by identity theft clearly have a valid claim of negligence liability against a business that was responsible for reasonably securing their confidential data, which in turn can be extended to a rule of strict liability due to the difficulties of proving negligence. The elements of this cause of action are not straightforward and require some justification, but ultimately the tort liability is best understood as a means for maintaining the integrity of the market.[128]

Tort liability, however, will not adequately address the pervasive problem of identity theft. The foregoing analysis does not consider the element of causation, which will bar many if not most victims from tort recovery. In 2014, according to a DOJ study, only "32% of identity theft victims knew how the offender obtained their personal information."[129] Unless victims are able to identify the business or other party that enabled the data theft, they will be unable to prove that any particular defendant caused their losses. These victims will have no tort remedy.

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127. *See supra* note 12 and accompanying text.

128. *See supra* notes 71–73 and accompanying text (discussing this policy as a rationale for the tort duty); *supra* notes 98–100 and accompanying text (discussing this policy as a rationale for the rule of strict liability).

129. Harrell, *supra* note 4, at 5.

Those who are able to identify the enabling party must still establish compensable damages. The DOJ study suggests that only 65% of them will experience some financial harm eligible for tort recovery.[130] If so, then only 21% of all identity theft victims will be able to successfully pursue the tort cause of action.[131] If the tort claims are further limited to those incurring financial loss of at least $100, the rate drops to 2%.[132] The elements of causation and damages ultimately pose the greatest obstacle to tort recovery for identity theft.

As these data strongly suggest, subjecting businesses to strict tort liability will not adequately protect the confidential information that has been entrusted to them by customers in the course of doing business. At best, tort law can only complement other regulatory efforts aimed at securing confidential consumer information in order to maintain the integrity of market transactions in the Information Age.

130. Approximately 65% of identity theft victims in 2014 reported some financial loss. *Id.* at 6. The 65% rate only applies to the more limited class of victims capable of identifying the source of the data loss if they are otherwise representative of the class as a whole.

131. Of the 32% who can establish causation, only 65% will otherwise have a claim for compensable damages, yielding an amount equal to 21% of the total.

132. Approximately 7% of identity theft victims in 2014 reported financial loss in excess of $100. *Id.* at 1. Assuming again that only 32% of these victims will be able to establish causation, then only 2% of all identity theft victims will be able to recover.