

# CAN COMPANIES DISCLAIM AND LIMIT LIABILITY FOR DATA BREACHES IN ONLINE TERMS OF SERVICE?

By Alex Pearce

Online service providers often include disclaimers and limitations of liability in standardized terms of service. Through these disclaimers and limitations, providers seek to do some combination of the following:

- disavow implied warranties and representations, using “as is” and other similar disclaimers;
- exclude liability for “loss of data,”
- exclude liability for indirect, incidental, and consequential damages; and
- limit liability for direct damages, sometimes to a nominal amount.

At first blush, these kinds of provisions—ubiquitous in standardized terms of service for free and low-cost online services—would seem to be especially helpful after a data breach. After all, in the era of major data breaches, the announcement by a provider

that it has been hacked is often quickly followed by the filing one or more consumer class-action lawsuits.

But can these provisions really protect a company against claims by individuals whose data has been compromised in a security breach?

This article looks at that question—in particular, two decisions by Judge Lucy H. Koh of the U.S. District Court for the Northern District of California in a case called *In re Yahoo! Inc. Customer Data Security Breach Litigation*.

## HACKS LEAD TO BILLIONS OF COMPROMISED ACCOUNTS—AND CONSUMER LAWSUITS

*In re Yahoo!* arose after hackers accessed user accounts for Yahoo’s free email and small business email and Web site services in a series of breaches between 2013 and 2016. In all, these breaches compromised 3 billion accounts—Yahoo’s entire user base. The hackers stole users’ login credentials and other personal information, and obtained access to the contents of their emails.

After Yahoo notified its users of these breaches, several lawsuits were filed against Yahoo. Those lawsuits focused in part on Yahoo’s terms of service, which Yahoo included in a clickwrap agreement that users had to view and accept before creating their accounts. In those terms of service, Yahoo made various promises about the security of users’ personal information:

- “We are committed to ensuring your information is protected and apply safeguards in accordance with applicable law.”
- “Yahoo does not rent, sell, or share personal information about you with other people or non-affiliated companies except to provide products or services you’ve requested, when we have your permission, or under [certain applicable circumstances].”
- “We limit access to Personal Information about You to employees, contractors, or service providers who we believe reasonably need to come into contact with that information to provide products or services to You or in order to do their jobs.”

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- “We have physical, electronic, and procedural safeguards that comply with federal regulations to protect personal information about you.”<sup>1</sup>

Yahoo, claimed the plaintiffs, failed to live up to these commitments and breached its terms of service by failing to implement reasonable safeguards to protect the plaintiffs’ user accounts. Among various other claims, their complaint asserted a claim for breach of contract based on the terms of service.

### **CAN DISCLAIMERS PREVENT A FINDING OF BREACH?**

Yahoo moved to dismiss under Federal Rule of Civil Procedure 12(b)(6).

Yahoo first argued that its terms of service contained express disclaimers that precluded a finding it breached any contract with the plaintiffs. Those disclaimers stated

- That the use of Yahoo’s services is “AT YOUR OWN RISK” and on an “AS IS,” and “AS AVAILABLE” basis;
- that Yahoo disclaimed any warranties its services were “UNINTERRUPTED, TIMELY, SECURE OR ERROR-FREE;”
- that “no data transmission over the Internet or information storage technology can be guaranteed to be 100 percent secure;” and
- that “SECURITY MECHANISMS IN THE SERVICES HAVE INHERENT LIMITATIONS.”<sup>2</sup>

Those disclaimers, argued Yahoo, showed that it never promised users a “completely secure, hack-proof environment.”<sup>3</sup>

Judge Koh rejected that argument, finding that the disclaimers could not override the affirmative security promises in the terms of service, including that it would “limit access to personal information” about the plaintiffs.<sup>4</sup> Indeed, reasoned the court, Yahoo’s statement that its security mechanisms had “inherent limitations” itself implied that Yahoo had at least some reasonable security mechanisms in place. As a result, Yahoo’s caveat that the services were not “100 percent secure” could not defeat the plaintiffs’ breach-of-contract claim.

### **CAN EXCLUSIONS AND LIMITATIONS OF LIABILITY DEFEAT A BREACH-OF-CONTRACT CLAIM?**

Yahoo also argued that limitations of liability in its terms of service precluded the recovery of consequential damages, such as out-of-pocket mitigation costs and the reduction in value of the plaintiffs’ personal information.

To that end, the terms of service contained the following clause limiting Yahoo’s liability:

YOU EXPRESSLY UNDERSTAND AND AGREE THAT YAHOO ... SHALL NOT BE LIABLE TO YOU FOR ANY PUNITIVE, INDIRECT, INCIDENTAL, SPECIAL, CONSEQUENTIAL OR EXEMPLARY DAMAGES, INCLUDING, BUT NOT LIMITED TO, DAMAGES FOR LOSS OF PROFITS, GOODWILL, USE, DATA OR OTHER INTANGIBLE LOSSES (EVEN IF YAHOO HAS BEEN ADVISED OF THE POSSIBILITY OF SUCH DAMAGES), RESULTING FROM: ... UNAUTHORIZED ACCESS TO OR ALTERATION OF YOUR TRANSMISSIONS OR DATA ... OR ... ANY OTHER MATTER RELATING TO THE YAHOO SERVICE.<sup>5</sup>

That clause, the court held, did not preclude liability for direct damages caused by the breach.<sup>6</sup> The court reserved for a later stage of the proceeding which categories of damages claimed by the plaintiffs fell into that category.

But, the court concluded, the limitation of liability did bar the recovery of out-of-pocket identity-theft mitigation costs, which the plaintiffs conceded were consequential damages.<sup>7</sup> Judge Koh therefore dismissed the plaintiffs’ breach-of-contract claim to the extent that claim sought to recover consequential damages.

The court also, however, invited the plaintiffs to amend their complaint, and gave the plaintiffs a roadmap to avoid dismissal the second time around. The plaintiffs, said Judge Koh, could make out a viable claim for consequential damages based on Yahoo’s breach of the terms of service if Yahoo’s limitations of liability were unconscionable.

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## ARE LIMITATIONS OF LIABILITY FOR DATA BREACH UNCONSCIONABLE?

The plaintiffs accepted the court's invitation and filed an amended complaint. That pleading characterized the limitations of liability in Yahoo's terms of service as both procedurally and substantively unconscionable.

The limitations were procedurally unconscionable, said the plaintiffs, because they involved both surprise and oppression—necessary elements of a claim that a contractual term is unconscionable under California law.<sup>8</sup> Those limitations, alleged the plaintiffs, appeared in the middle of a clickwrap agreement and could only be viewed after a user scrolled through what the plaintiffs characterized as “many pages of contract legalese.” And Yahoo offered that agreement on a take it or leave it basis with no opportunity for negotiation or modification.

As to substantive unconscionability, the plaintiffs alleged federal and state law already required Yahoo to maintain reasonable data security measures. By seeking to avoid responsibility for consequential damages—a “clear and well-understood consequence of a data breach,”—Yahoo, “an Internet titan,” was unfairly seeking to re-allocate risk to individuals “who just want to sign up for an email address.”

Yahoo again moved to dismiss. It argued the plaintiffs could not show “surprise” because the limitations were clear, conspicuous, and prominently displayed in bold typeface. Nor, argued Yahoo, were those limitations oppressive: the plaintiffs willingly chose to sign up for Yahoo's service from “a field of alternative mail service providers.”

Yahoo also argued that it was the *plaintiffs* who were seeking an unfair allocation of risk. Yahoo offered its services on a free or low-cost basis, and exercised no control over whether and how the plaintiffs used their free or low-cost email to transmit sensitive personal information. Yahoo, the company argued, should not have to bear the full economic risk of the plaintiffs' choices in that regard.

### THE COURT'S DECISION

The court sided with the plaintiffs in a March 2018 decision that denied Yahoo's motion to

dismiss the breach-of-contract claims in the amended complaint.<sup>9</sup>

The court first concluded that the amended complaint adequately alleged procedural unconscionability because Yahoo's limitations appeared near the end of a “12-page legal Terms of Service Document where the Terms of Service are contained in an adhesion contract and customers may not negotiate or modify any terms.”<sup>10</sup> That conclusion relied on a Ninth Circuit decision that held a contract is procedurally unconscionable if it is “a standardized contract, drafted by the party of superior bargaining strength, that relegates to the subscribing party only the opportunity to adhere to the contract or reject it.”<sup>11</sup>

The mere fact that the plaintiffs could use other email service providers “might weaken” the plaintiffs' procedural unconscionability allegations, but could not overcome them.<sup>12</sup>

The court also rejected Yahoo's substantive unconscionability arguments. Yahoo's limitations, the court reasoned, effectively guaranteed that the plaintiffs “could not possibly obtain anything approaching full recompense for their harm.”<sup>13</sup> And in the court's view, Yahoo's risk allocation arguments did not justify that outcome. The court acknowledged that it might be commercially reasonable for a defendant who offers a free or low-cost service to minimize its exposure to monetary damages claims by users of the service.<sup>14</sup> But viewed in light of the plaintiffs' allegations that Yahoo took “minimal action despite knowing about their inadequate security measures,” the plaintiffs' substantive unconscionability allegations were enough to get past Rule 12(b)(6).<sup>15</sup>

Having reached those conclusions, Judge Koh denied Yahoo's motion to dismiss the plaintiffs' breach-of-contract claim.

### LESSONS FOR ONLINE SERVICE PROVIDERS

The decisions in *In Re Yahoo!* contain some important lessons for the online services providers that collect personal information from their users.

First, the case shows the risk that privacy statements and terms of service can create when they incorporate affirmative data-security promises. In most cases, the law does not require service providers

to make any affirmative representations about their data security measures in customer-facing privacy policies and terms of service. While doing so might serve other goals—promoting user trust, for example—these can come at the cost of increased exposure to breach-of-contract claims in the wake of a data breach.

Second, the case makes clear that boilerplate disclaimers that a service is not “100 percent secure” or is provided on an “as is” basis are not likely to protect against data breach claims. When a company has made affirmative security promises, conflicting disclaimers cannot overcome them.

Finally, limitations of liability may not provide a reliable shield against consumer data-breach lawsuits at the pleadings stage, even when limited to consequential and other indirect damages. Judge Koh’s reasoning on unconscionability would seem to lead to a similar outcome for any limitations of liability that appear in standardized terms of service—at least in the context of data breach lawsuits.

In other words, courts may be just as likely as users themselves to ignore online terms of service when it

comes to disclaimers and limitations of liability for data breaches.

## NOTES

1. *In re Yahoo! Inc. Customer Data Security Breach Litig.*, No. 16-MD-02752-LHK, 2017 WL 3727318, at \*44 (N.D. Cal. August 30, 2017).
2. *Id.* at \*45.
3. *Id.*
4. *Id.*
5. *Id.* at 46.
6. *Id.*
7. *Id.*
8. *Pokorny v. Quixtar, Inc.*, 601 F.3d 987, 996 (9th Cir. 2010)
9. *In re Yahoo! Inc. Customer Data Security Breach Litig.*, No. 16-MD-02752-LHK, 2018 WL 1243332 (N.D. Cal. March 9, 2018) (*In re Yahoo II*).
10. *Id.* at \*15.
11. *Pokorny*, 601 F.3d at 996.
12. *In re Yahoo II*, 2018 WL 1243332 at \*15.
13. *Id.* at \*16 (quoting *Lhotka v. Geographic Expeditions, Inc.*, 104 Cal. Rptr. 3d 844, 852 (Cal. Ct. App. 2010)).
14. *Id.* at \*16.
15. *Id.*