

Customer Data Sale In Bankruptcy: Lessons From RadioShack

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Many businesses rely on personally identifiable information (PII) in maintaining and servicing their customers. Increasingly, this information goes well beyond mere customer lists and includes data regarding customer preferences and purchasing history. As a result, selling a business often means selling PII. Selling this intangible asset requires special attention, and a seller of PII should carefully examine its right to sell the PII as well as promises it previously made to consumers regarding its disposal.

This applies even when the sale occurs in bankruptcy. While bankruptcy courts in many contexts have the ability to modify a debtor's obligations to help ensure a successful reorganization or liquidation, the Bankruptcy Code limits courts' ability to approve a sale or lease of PII inconsistent with the debtor's prior promises. The recent sale involving PII in *In re RadioShack Corp. et al.*, Case No. 15-10197 (Bankr. D. Del.) illustrates some of the issues that can arise in bankruptcy, particularly where the proposed sale of PII contradicts the debtor's previous promises that it would not sell consumer data.



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The Proposed Sale of PII in RadioShack

RadioShack Corp. and affiliated entities (collectively, "RadioShack") filed for Chapter 11 bankruptcy in February 2015 and received court approval to sell approximately 1,700 stores as going concerns to General Wireless Inc. in March 2015. RadioShack did not include in this initial sale its extensive database of customer records pertaining to approximately 117 million customers.

In April 2015, RadioShack proposed a sale of its customer records database along with a package of intellectual property for \$26 million to an operating affiliate of General Wireless Inc. ("General Wireless Operations"), subject to higher and better bids. This proposal drew several objections, as discussed below, including objections from dealers and franchisees, business partners and state regulators. Ultimately the sale of the PII went forward and was approved on June 6, 2015. In obtaining approval of the sale, RadioShack had to toss out much of the PII from the deal at the demands of the sale objectors.

Does the Debtor Have the Right to Sell the PII?

RadioShack highlighted an obvious initial question in determining whether to sell PII: what rights does the debtor have with respect to the PII? Agreements between the debtor and vendors, service providers or other companies can limit the debtor's right to sell PII in a debtor's possession. At the very least, ambiguities in prior agreements can lead to litigation, delay and concessions on the part of the seller.

In RadioShack, several of RadioShack's business partners objected to the sale of PII based on the terms

of various reseller agreements. The objectors argued that pursuant to reseller agreements, PII collected by RadioShack from the partners' customers was not RadioShack's to sell. In addition, they posited that reseller agreements with RadioShack prohibited RadioShack from selling PII concerning their customers.

RadioShack responded that it intended to remove from the transferred data product-identifying stock numbers or descriptions that related to the objectors. As a result, RadioShack argued the PII for sale pertained only to its own customers. Containing no reference to the objectors or their products, RadioShack maintained that the PII for sale was not subject to the reseller agreements and could be sold without their approval.

Ultimately, the objectors settled their disputes with RadioShack by either (1) mandating that RadioShack not transfer any customer or transaction data where only the objectors' products or services were purchased or (2) requiring General Wireless Operations to abide by the terms of the objector's reseller agreement.

Agreements with third parties involving the collection of customer data in some form are increasingly common. A trustee or debtor in possession intending to sell PII may avoid delay and risk by identifying and working with third parties that may have claim to the PII early in the sale negotiations. More generally, businesses reviewing or entering into agreements involving the collection of PII may want to consider including provisions allowing for more flexible transitions to third-party purchasers, especially where a purchaser intends to purchase the PII as a part of purchasing the business.

Has the Debtor Promised Not to Sell the PII?

In addition to agreements with third parties, a debtor's consumer-facing privacy policy may also affect the ability of a trustee or debtor in possession to sell PII belonging to the debtor. In bankruptcy, if a debtor's privacy policy prohibits the sale or transfer of PII, the Bankruptcy Code in Section 332 provides that the PII may still be sold, but only under the supervision and approval of a "consumer privacy ombudsman" and the bankruptcy court. As discussed below, obtaining the approval of the privacy ombudsman and the court may require the debtor to make significant concessions regarding the amount of PII sold.

In RadioShack, the U.S. trustee requested appointment of a consumer privacy ombudsman after RadioShack's proposed sale of 1,700 stores to General Wireless Inc. initially appeared to involve selling PII inconsistent with RadioShack's prior promises to the contrary. The U.S. trustee noted that RadioShack's privacy policy posted on radioshack.com stated "[w]e will not sell or rent your personally identifiable information to anyone at any time." The court agreed with the U.S. trustee and ordered that a consumer privacy ombudsman be appointed. The ombudsman played an active role in RadioShack's later sale of PII to General Wireless Operations.

A debtor's privacy policy can also be the subject of scrutiny by federal and state regulators in connection with a proposed sale of PII. Fifteen years ago, in *In re Toysmart.com LLC*, Case No. 00-13995 (Bankr. D. Del.), the Federal Trade Commission delayed a sale of PII based on promises made in a privacy policy. In that case, the FTC blocked the toy retailer from auctioning off its customer's PII because it had promised its customers it would not share PII with third parties. The FTC alleged that doing so would amount to a deceptive or unfair practice under Section 5 of the FTC Act. Toysmart and the FTC eventually reached a settlement in which Toysmart agreed to sell the PII to a buyer in a related market subject to certain restrictions concerning the third party's use of the PII and as part of a package deal rather than as a

stand-alone asset.

Since Toysmart, many privacy policies have included a provision that allows the sale of customer lists or other customer data in the context of mergers, acquisitions, bankruptcies and other restructurings. However, RadioShack's privacy policies did not contain such a provision, and the FTC wrote a letter to the privacy ombudsman in RadioShack highlighting this fact and identifying sections of RadioShack's privacy policies and in-store signage that promised consumers that RadioShack would not sell their PII.

Citing the framework of its settlement in the Toysmart case, the FTC recommended that the sale proceed in accordance with the following terms that would alleviate the FTC's concerns:

- The PII is not sold as a stand-alone asset;
- The buyer is engaged in substantially the same lines of business as RadioShack;
- The buyer expressly agrees to be bound by and adhere to the terms of RadioShack's privacy policies as to the personal information acquired from RadioShack; and
- The buyer agrees to obtain affirmative consent from consumers for any material changes to the policy that affect information collected under the RadioShack policies.

Alternatively, the FTC proposed that RadioShack require its customers to affirmatively consent to the transfer of their information before including it in a sale. The FTC's letter indicates that consistent with its attitude in Toysmart, the FTC continues to disapprove of sales of PII as a stand-alone asset at auction where it could be sold to an unknown third party not involved in the same lines of business as the debtor.

State regulators also analyzed RadioShack's privacy policies and objected to RadioShack's sale of PII. Texas was the first of 38 state attorneys general to object to RadioShack's proposed sale based on state consumer privacy laws. Texas, followed by other states, argued that RadioShack's privacy policies all contain an "unequivocal" provision that PII would not be sold and that doing so would violate state law.

The Approved Sale Terms in RadioShack

RadioShack's sale of PII was approved, albeit in a limited form. Under an agreement between RadioShack, General Wireless Operations, the state of Texas and other objecting states (the terms were approved by all objecting states), RadioShack was required to significantly limit the amount of PII transferred. For example, RadioShack agreed to transfer only those email addresses that were active in the two years prior to the petition date. In addition, only seven fields of transaction data would be included (i.e., store number, ticket date/time, tender amount) rather than the 21 fields previously proposed. RadioShack also agreed to exclude customer telephone numbers from the sale.

Although not party to the settlement agreement, the FTC reportedly played an active role in the mediation and was satisfied that the settlement agreement satisfied the four criteria set forth above and first applied in Toysmart. Consistent with the FTC's recommendations, the purchaser agreed to be bound by RadioShack's applicable privacy policies and require customers to affirmatively consent to any material change thereto. In addition, although not required by Toysmart or the FTC, the parties agreed that customers would receive notice of the transfer of their PII and have the opportunity to opt out and withhold their PII from the sale.

RadioShack provides a recent illustration of what a bankruptcy trustee or debtor in possession can expect when attempting to sell PII where the debtor's right to sell the PII is not unambiguous and where the debtor previously promised consumers that it would not sell their PII. Without a clear basis to do so, selling PII can result in additional litigation (or mediation) to resolve the objections of federal and state regulators and any third parties who claim rights over the PII. It is best to identify and resolve these concerns as early in the sale process as possible. RadioShack also highlights the importance of taking the long view in reviewing and drafting privacy policies and agreements involving the collection of PII. Nearly all of these disputes could have been avoided had RadioShack made appropriate exceptions for the transfer of PII upon the sale of the business.

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