

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:)	Chapter 11
)	
MARBLES HOLDINGS, LLC, <u>et al.</u> , ¹)	Case No. 17-3309
)	Jointly Administered
Debtors.)	
)	Honorable Timothy A. Barnes

REPORT OF THE CONSUMER PRIVACY OMBUDSMAN

Elise S. Frejka, CIPP/US
Consumer Privacy Ombudsman
FREJKA PLLC
205 East 42nd Street – 20th Floor
New York, New York 10017
Telephone: (212) 641-0800
efrejka@frejka.com

April 24, 2017

¹ The debtors in these Chapter 11 cases, along with the last four digits of each debtor's federal taxpayer identification number, are (i) Marbles Holdings, LLC (9547); Marbles LLC (3081); and Marbles Brain Workshop, LLC (0303).

TABLE OF CONTENTS

RECOMMENDATIONS.....	2
Individual Customer Information if Buyer is a “Qualified Buyer”	2
Individual Customer Information if Buyer is Not a “Qualified Buyer”	4
BACKGROUND	5
The Sale Motion.....	5
Review of the Debtors’ Privacy Policies and Practices	7
Individual Customer Information Collected by the Debtors.....	7
Individual Customer Information to be Sold	10
The Debtors’ Privacy Policies	10
ANALYSIS.....	11
Individual Customer Information	12
Applicable Nonbankruptcy Law	12
The Federal Trade Commission Act	13
Children’s Online Privacy Protection Act	15
Gramm-Leach-Bliley Act	16
Applicable State Laws	16
Other Considerations	17
The Debtors’ Privacy Policies	18
Privacy Impact on Consumers if the Sale Proceeds.....	18
Alternative Solutions that Might Mitigate the Privacy Impact.....	19
The Buyer is a “Qualified Buyer”	20
CONCLUSION.....	20

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION**

In re:)	Chapter 11
)	
MARBLES HOLDINGS, LLC, <u>et al.</u> , ¹)	Case No. 17-3309
)	Jointly Administered
Debtors.)	
)	Honorable Timothy A. Barnes

REPORT OF THE CONSUMER PRIVACY OMBUDSMAN

Elise S. Frejka, the consumer privacy ombudsman² in the above-captioned cases (the “Ombudsman”) files this report (the “Report”) to assist the Bankruptcy Court in its consideration of the facts, circumstances and conditions of the proposed sale (the “Sale”) of personally identifiable information (“PII”)³ of consumers of Marbles Holdings, LLC and its debtor subsidiaries (collectively the “Debtors”) to Spin Master, Ltd. (or its designee) (the “Buyer”) pursuant to the Asset Purchase Agreement dated as of April 7, 2017, as may be amended or supplemented (the “Asset Purchase Agreement”).

¹ The debtors in these Chapter 11 cases, along with the last four digits of each debtor’s federal taxpayer identification number, are (i) Marbles Holdings, LLC (9547); (ii) Marbles LLC (3081); and (iii) Marbles Brain Workshop, LLC (0303).

² See Order Directing the United States Trustee to Appoint a Consumer Privacy Ombudsman [ECF No. 216]; Notice of Appointment of Consumer Privacy Ombudsman Pursuant to 11 U.S.C. § 332 [ECF No. 220].

³ Pursuant to 11 U.S.C. § 101(41A), [t]he term “PII” means—

(A) if provided by an individual to the debtor in connection with obtaining a product or a service from the debtor primarily for personal, family, or household purposes—

- (i) the first name (or initial) and last name of such individual, whether given at birth or time of adoption, or resulting from a lawful change of name;
- (ii) the geographical address or a physical place of residence of such individual;
- (iii) an electronic address (including an e-mail address) of such individual;
- (iv) a telephone number dedicated to contacting such individual at such physical place of residence;
- (v) a social security account number issued to such individual; or
- (vi) the account number of a credit card issued to such individual[.]

11 U.S.C. § 101(41A)

RECOMMENDATIONS

After a review of the facts and circumstances, and as more fully discussed in this Report, the Ombudsman recommends⁴ that the Bankruptcy Court approve the proposed sale and transfer of the Debtors' customer lists and other customer-related information (the "Individual Customer Information") as part of the sale of the e-commerce business of the Debtors to the Buyer, subject to the following recommendations:

Individual Customer Information if Buyer is a "Qualified Buyer"

PII that was collected from consumers may be sold and transferred to the Buyer; provided that:

- The Debtors demonstrate, and the Court finds, that the Buyer is a "Qualified Buyer"⁵.
- The following Individual Customer Information is excluded from the Sale: (i) the email address of any consumer who unsubscribed or "opted-out"⁶ from receiving marketing communications from the Debtors (the "Unsubscribe Consumers") and (ii) the customer file of any consumer who is enrolled in the Marbles Loyalty Program but who did not also sign up to receive promotional emails (the "Loyalty Program Only Consumers") (collectively, the "Non-Transferable Consumer Files").
- The Buyer agrees to (i) become the successor-in-interest to the Debtors' privacy policy that was in effect on the Petition Date or on terms that are at least as

⁴ The Ombudsman shared a preliminary draft of the recommendations with the Debtors and counsel for the Buyer on April 21, 2017.

⁵ For purposes of this Report, the Ombudsman intends "Qualified Buyer" to mean an entity that is acquiring PII as part of a larger asset sale and (a) agrees to operate the e-commerce business as a going concern, and that concentrates in the same business or market as the Debtors; (b) expressly agrees to be bound by, and succeed to, the Debtors' existing privacy policies; (c) agrees to be responsible for any violation of existing privacy policies; and (d) agrees that prior to making any material change to the Debtors' existing privacy policies, affirmative consumer consent will be obtained. See Stipulation and [Proposed] Order Establishing Conditions on Sale of Customer Information, In re Toysmart.com, LLC, Civil Action No. 00-13995-CJK (Bankr. E.D. Mass. 2000), <https://www.ftc.gov/sites/default/files/documents/cases/toysmartbankruptcy.1.htm>. In Toysmart, the debtor sought bankruptcy court approval to sell certain assets, including its customer lists, through a public auction. However, this was directly contrary to Toysmart's privacy policy; the FTC sought to enjoin the sale. A copy of the Toysmart Stipulation and [Proposed] Order Establishing Conditions on Sale of Customer Information is attached hereto as Exhibit A.

⁶ "Opt-in" consent requires affirmative steps by a consumer to allow the collection and/or use of information; "Opt-out" consent requires affirmative steps to prevent the collection and/or use of information.

protective of consumer privacy; (ii) adhere to all material terms of the Privacy Policy; and (iii) be liable for any violation of the Privacy Policy after the closing of the Sale (the "Closing").

- The Buyer agrees to notify customers of the Sale by:
 - Posting a clear and conspicuous notice on its website for a period of six (6) months from the Closing advising consumers that: (i) the Buyer was the successful bidder for the Debtors' e-commerce business; (ii) as a result of the Sale, the Buyer purchased PII of customers of the Debtors; (iii) the Buyer is the successor-in-interest under the Debtors' Privacy Policy; and (iv) consumers have the opportunity to opt-out from receiving communications from the Buyer and be removed from the customer database. Such notice should include a website address for consumers to effectuate any opt-out request.
 - Emailing, within sixty (60) days of the Closing, customers whose email addresses are being acquired by the Buyer. Such email should clearly and conspicuously advise such customers that: (i) the Buyer was the successful bidder for the Debtors' e-commerce business; (ii) as a result of the Sale, the Buyer purchased PII of customers of the Debtors; (iii) the Buyer is the successor-in-interest under the Debtors' Privacy Policy and (iv) their email addresses will be transferred to the Buyer unless an opt-out request is received within seven (7) days of receipt of the email. The email notification should contain a hyperlink for customers to effectuate any opt-out request. In addition, such email notification should be conducted by a third-party and customer email addresses should not be transferred to the Buyer until after the conclusion of the aforementioned opt-out period.
- The Debtors should (i) destroy or cause to be destroyed within seventy-five (75) days of the Closing, in a manner consistent with industry standard data security protections and applicable information security laws and best practices, all Non-Transferable Customer Files, and (ii) file a Certificate of Destruction with the Bankruptcy Court confirming such destruction.
- The Buyer agrees that prior to making any material change to any of the Privacy Policies, including any changes to the use or disclosure of PII, the Buyer will, to the extent required by applicable law: (i) provide consumers with notice of the proposed change; (ii) direct consumers to the Buyer's privacy policy; and (iii) provide each consumer with the opportunity to opt-in to the proposed change to the privacy policy with any such modifications only being binding on those consumers who opt-in.
- The Buyer agrees to safeguard all PII in a manner consistent with industry standard data security protections and applicable information security laws and best practices.

- The Buyer agrees to destroy all PII for which it determines it has no reasonable business need.
- The Buyer agrees to file a notice with the Bankruptcy Court within seventy (75) days after the Closing, (i) stating that it is in compliance with the foregoing provisions, and (ii) certifying that it will comply with any ongoing obligations in accordance with these provisions.

Individual Customer Information if Buyer is Not a “Qualified Buyer”

If, for any reason, the Debtors do not establish that the Buyer is a “Qualified Buyer,” then PII that was collected from the Debtors’ customers should not be sold and transferred to the Buyer unless:

- The Buyer agrees, at a minimum, to abide by the Debtors’ existing Privacy Policy, as in effect on the Petition Date.
- The Debtors agree to notify all consumers (by email or postal mail, as applicable) that they are seeking to transfer PII to the Buyer in connection with the Sale.
- In connection with the Debtors’ notification of the Sale, the Debtors agree (i) to provide consumers with the opportunity to opt-in to the transfer of their PII to the Buyer, and (ii) to clearly and conspicuously state in such notification that the consumer’s PII will only be transferred to the Buyer if such consumer affirmatively consents to the transfer.
- The Debtors agree that only the PII of consumers who opt-in may be sold and transferred to the Buyer.
- The Debtors agree to file a notice with the Bankruptcy Court within sixty (60) days after the Closing stating that they have complied with the foregoing provisions.

These recommendations are consistent with those made by consumer privacy ombudsmen in other bankruptcy cases who have encountered similar facts – i.e., a proposed sale of PII that is, or may be, contrary to the terms of the debtor’s existing privacy policy.⁷ In broad

⁷ See, e.g., In re Wet Seal, LLC, Case No.: 17-10229 (CSS) (Bankr. D. DE 2017) [ECF No.: 2221]; In re BPS US Holdings Inc., et al., Case No.: 16-12373 (KJC) (Bankr. D. DE 2016) [ECF No.: 720]; In re Great Atlantic & Pacific Tea Company, Inc., et al., Case No.: 15-23007 (RDD) (Bankr. S.D.N.Y. 2015) [ECF No.: 872]; In re RS Legacy Corp., Case No.: 15-10197 (BLS) (Bankr. D. DE 2015) [ECF No.: 2148]; In re Deb Stores Holdings, LLC, Case No.: 14-12676 (KG) (Bankr. D. DE 2014) [ECF No.: 272]; In re deliA*s, Inc., Case No.: 14-23678 (RDD) (Bankr. S.D.N.Y. 2014) [ECF No.: 557]; In re CWC Liquidation Inc. f/k/a Coldwater Creek, Inc., Case

terms, consumer privacy ombudsmen have recommended, and Bankruptcy Courts have approved, the sale of PII in contravention of a debtor's existing privacy policy; provided that: (i) the sale is made to a "Qualified Buyer;" (ii) the purchaser is the successor-in-interest to the debtor's privacy policy; and (iii) consumers are afforded notice of the proposed sale and given an opportunity to opt-out of the proposed transfer of PII. As such, the Ombudsman believes the above recommendations are consistent with applicable precedent, including FTC rulings and prior consumer privacy ombudsman recommendations in other bankruptcy cases.

The Ombudsman believes implementation of these recommendations will adequately address the transfer of PII in a manner that protects consumers' PII while facilitating the Sale for the benefit of the Debtors' estates.

BACKGROUND

The Sale Motion

1. On February 3, 2017 (the "Petition Date") each of the Debtors filed voluntary petitions for relief under Chapter 11 of title 11, United States Code, as amended (the "Bankruptcy Code"). Since the Petition Date, the Debtors have remained in possession of their assets and have continued to operate their businesses as debtors in possession in accordance with sections 1107(a) and 1108 of the Bankruptcy Code.

2. On March 30, 2017, the Debtors filed the Motion of the Debtors for the Entry of an Order: (A) Approving The Sale Process And Bidding Procedures with Respect to Sale of E-Commerce and Wholesale Business Assets and Certain Other Assets of the Estates; (B)

No.: 14-10867 (DHS) (Bankr. D. DE 2014) [ECF No.: 339, 425]; In re Crumbs Bake Shop, Inc., Case No.: 14-24287 (MBK) (Bankr. D.N.J. 2014) [ECF No.: 174]; In re Kid Brands, Inc., Case No.: 14-22582 (DHS) (Bankr. D.N.J. 2014) [ECF No.: 280]; In re Dots, LLC, Case No.: 14-11016 (DHS) (Bankr. D.N.J. 2014) (ECF No.: 624); In re Loehmann's Holdings Inc., Case No.: 13-14050 (MG) (Bankr. S.D.N.Y. 2013) [ECF No.: 196]; In re Real Mex Restaurants, Inc., (Case No.: 11-13122 (BLS) (Bankr. D. Del. 2011) [ECF No.: 877]; In re Borders Group, Inc., Case No.: 11-10614 (MG) (Bankr. S.D.N.Y. 2011) [ECF No.: 1830]; In re Circuit City Stores, Inc., Case No.: 08-35653 (KRH) (Bankr. E.D. Va. 2008) [ECF No.: 3318].

Approving Form of and Authorizing the Debtors to Enter into Stalking Horse Asset Purchase Agreement; (C) Approving Bid Protection; (D) Scheduling A Public Auction and Subsequent Sale Hearing; (E) Authorizing the Sale of the Assets of the Debtors Free and Clear of Liens, Claims, Encumbrances and Interests; (F) Authorizing the Assumption and Assignment of Executory Contracts and Unexpired Leases; and (G) Approving The Form Of Notice and Manner of Notice of Sale Hearing and Proposed Assumption and Assignment [ECF No. 201] (the “Sale Motion”).

3. The Sale Motion contemplates that the Debtors will sell to the Buyer, among other things, the Debtors’ PII as part of a larger sale of the E-Commerce Platform.

4. On April 7, 2017, the Bankruptcy Court entered that certain Order: (a) Approving the Sale Process and Bidding Procedures with Respect to Sale of E-Commerce and Wholesale Business Assets and Certain Other Assets of the Estates; (b) Approving Form of and Authorizing Debtors to Enter into Stalking Horse Asset Purchase Agreement; (c) Approving Bid Protection; (d) Scheduling a Public Auction and Subsequent Sale Hearing; (e) Authorizing the Sale of the Assets of the Debtors Free and Clear of Liens, Claims, Encumbrances and Interests; (f) Authorizing the Assumption and Assignment of Executory Contracts and Unexpired Leases; and (g) Approving the Form of Notice and Manner of Notice of Sale Hearing and Proposed Assumption and Assignment (the “Bidding Procedures Order”) [ECF No. 217].

5. The Debtors did not receive any Qualified Bids (as such term is defined in the Sale Motion) prior to the deadline of April 20, 2017, the auction was cancelled, and the Debtors will seek approval of the Sale to the Buyer at a hearing before the Bankruptcy Court scheduled for April 26, 2017.

Review of the Debtors' Privacy Policies and Practices

6. In performing her duties, the Ombudsman has relied upon and reviewed, among other things, the following:

- a. The Debtors' Privacy Policy in effect on the Petition Date (<http://www.marblesthebrainstore.com/Connect/privacy-and-terms.htm>) (attached hereto as Exhibit B);
- b. The Marbles Loyalty Terms, Conditions of Use and Privacy Policy in effect on the Petition Date (<http://www.marblesthebrainstore.com/Members/rewards-program-terms-conditions.htm>) (attached hereto as Exhibit C);
- c. Declaration of Girisha Chandraraj in Support of Chapter 11 Petitions and First-Day Motions [ECF No. 7];
- d. Telephone interviews and discussions with (i) counsel for the Debtors; (ii) internal representatives of the Debtors, including (a) Michael Smith, Chief Executive Officer/Chief Financial Officer and (b) Ema Ode, Director of Ecommerce; (iii) David Peress, Hilco IP Services, LLC d/b/a/ Hilco Streambank; and (iv) counsel for the Buyer;
- e. The Sale Motion and the Bidding Procedures Order;
- f. The Debtors' privacy practices and collection procedures concerning PII, including the Debtors' database maintenance procedures for PII, and their procedures for the sharing and use of such information;
- g. Research and review of case law, commentaries, and court orders from bankruptcy cases involving the sale of PII;
- h. Applicable United States federal and state privacy laws, regulations, enforcement actions, guidance and industry best practices;
- i. The Asset Purchase Agreement; and
- j. The privacy policy of the Buyer available at <http://www.spinmaster.com/privacy-policy.php>.

Individual Customer Information Collected by the Debtors

7. The facts in this Report are based solely upon the Ombudsman's information and belief, based upon her discussions with representatives of the Debtors and information provided by the Debtors.

8. The Debtors are a developer, wholesaler, and specialty retailer of games, puzzles, books and software designed to strengthen and simulate the brain. The Debtors have three primary business segments: retail stores (the “Retail Stores”), e-commerce, and wholesale. In addition to the sale of merchandise through the Retail Stores, the Debtors also sell merchandise directly to consumers through the www.marblesthebrainstore.com e-commerce platform (the “E-Commerce Platform”) and to retailers and wholesalers located in North America, Europe and Australia (the “Wholesale Platform”).

9. The Sale Motion contemplates the sale of Individual Customer Information collected from consumers both in the Retail Stores and from the E-Commerce Platform. In the aggregate, the Debtors have PII from 741,048 unique consumers that consists of 741,048 consumer email addresses, 176,331 physical mailing addresses and 107,619 phone numbers. This customer information is PII as the Bankruptcy Code defines such term.

10. Marbles Loyalty Program: PII is collected as part of the Marbles Loyalty Program. Consumers may enroll in the Marbles Loyalty program by providing an email address. The Marbles Loyalty program is a structured marketing effort that rewards loyal buying behavior. By providing an email address at the point of purchase, a consumer earns \$20 in MarblesCASH for every \$200 spent in stores or online. The Rewards Database is hosted by Clutch (www.clutch.com) – a third party consumer management platform – and contains 628,918 unique consumer email addresses, 125,893 valid mailing addresses and the consumer’s purchasing history (the “Rewards Database”). Historically, the Debtors have not separately marketed to the Rewards Database unless the consumer has also separately signed up to receive marketing materials. The Ombudsman understands from her review of the Asset Purchase

Agreement that the Buyer does not intend to continue the Marbles Loyalty Program or assume the obligations associated with the Marbles Loyalty Program.

11. Marketing Database. PII is collected directly from the E-Commerce Platform. Consumers are afforded the opportunity to sign-up to receive marketing information from the Debtors through a link on the E-Commerce Platform. Consumers enroll by providing an email address and consenting to receiving marketing emails from the Debtors. Consumer information collected in this manner is stored in a database hosted by MailChimp (www.mailchimp.com) – a third party email marketing platform (the “Marketing Database”). The Marketing Database contains 341,786 consumer files containing PII. Specifically, 292,468 consumers are members of both the Marbles Loyalty Program and have signed-up for the Marketing Database, while 49,318 consumers are only members of the Marketing Database.

12. E-Commerce Payment Processing. The Ombudsman has been advised that consumers purchases on the E-Commerce Platform are processed by a third party vendor – Aptos, Inc. (www.aptos.com) – and that the Debtors do not retain any financial information about the consumer except for the last four numbers of a credit card which is retained solely to process and track chargebacks/returns. The Ombudsman has been further advised that Aptos notified the Debtors in February 2017 that there had been a data breach that compromised certain PII for the Debtors’ customers and other Aptos ecommerce clients. The Ombudsman has been informed that the scope of the breach with respect to the Debtors is limited to approximately 99,000 consumer files that were potentially compromised, and the Debtors are in discussions with Aptos and the Buyer in an effort to notify all affected have initiated a program to inform all consumers of the breach.

Individual Customer Information to be Sold

13. The Asset Purchase Agreement contemplates that the Buyer will acquire Individual Customer Information. The assets to be acquired by the Buyer, include:

“Acquired Assets” means . . .

(v) Subject to the applicable provisions of the Bankruptcy Code, and further order of the Bankruptcy Court, all “personally identifiable information,” as defined in section 101(41A) of the Bankruptcy Code, including without limitation, all information maintained by [the Debtors] in the ordinary course of the E-Commerce/Wholesale Business provided by a natural person(s) to [the Debtors] in connection with (1) obtaining merchandise sold by [the Debtors]; or (2) membership in any rewards program offered by [the Debtors], in each case used or developed by [the Debtors] in connection with the E-Commerce/Wholesale Business, but excluding any of the foregoing related to the Excluded Assets (collectively, the “Individual Customer Information”);

Asset Purchase Agreement at Section 1(a)(v).

14. The Buyer is expressly not assuming any liability or obligation of any kind or nature arising from the operating the Debtors’ business from and after the Closing related to the Acquired Assets. See Asset Purchase Agreement at Section 13.

The Debtors’ Privacy Policies

15. The Debtors have two (2) privacy policies applicable to consumer information – the Web Site terms, Conditions of Use and Privacy Policy and the Marbles Loyalty Terms, Conditions of Use and Privacy Policy (collectively, the “Privacy Policies”). The Privacy Policies are identical in neither contemplates nor expressly authorizes the sale of PII. Specifically, the Privacy Policies each provide:

Your privacy is very important to us. Accordingly, we have developed this Policy in order for you to understand how we collect, use, communicate and disclose and make use of personal information. The following outlines our privacy policy.

- Before or at the time of collecting personal information, we will identify the purposes for which information is being collected.
- We will collect and use of personal information solely with the objective of fulfilling those purposes specified by us and for other compatible purposes, unless

- we obtain the consent of the individual concerned or as required by law.
- We will only retain personal information as long as necessary for the fulfillment of those purposes.
- We will collect personal information by lawful and fair means and, where appropriate, with the knowledge or consent of the individual concerned.
- Personal data should be relevant to the purposes for which it is to be used, and, to the extent necessary for those purposes, should be accurate, complete, and up-to-date.
- We will protect personal information by reasonable security safeguards against loss or theft, as well as unauthorized access, disclosure, copying, use or modification.
- We will make readily available to customers information about our policies and practices relating to the management of personal information.

We are committed to conducting our business in accordance with these principles in order to ensure that the confidentiality of personal information is protected and maintained.

The personally identifiable information that you provide to us (such as your name, address and email address) and information about your order may be combined with other personally identifiable information (such as demographic information and past purchase history) available from our records and other sources. This information will be used to make our future marketing efforts more efficient. This information may also be shared with our third party service providers that assist us with our marketing efforts and with other marketers whose products or services we feel may be of interest to you. If you prefer that we do not share your personally identifiable information with other marketers, please email us at support@marblethebrainstore.com.

ANALYSIS

16. Section 363(b)(1) of the Bankruptcy Code governs a debtor's ability to "use, sell, or lease" PII. Generally, a debtor may not sell or lease PII if, at the time of the commencement of a bankruptcy case, the debtor's privacy policy prohibits the transfer of PII to unaffiliated entities.⁸ Notwithstanding this general prohibition, a sale is permitted, pursuant to section 363(b)(1)(B) of the Bankruptcy Code, if:

after the appointment of a consumer privacy ombudsman, the court approves the sale (i) giving consideration to the facts, circumstances, and conditions of the sale and (ii) finding that no showing was made that the sale would

⁸ See 11 U.S.C. § 363(b)(1).

violate applicable nonbankruptcy law.⁹

17. Section 363(b)(1) of the Bankruptcy Code directs the Court to consider whether the proposed sale is consistent with Debtor's privacy policy in effect on the date of the commencement of the case or violates applicable nonbankruptcy law. The issue of whether the sale violates applicable nonbankruptcy law requires the consideration of the terms of Debtors' Privacy Policies and any other privacy representations made by Debtors to consumers.

Individual Customer Information

18. The Debtors' Privacy Policies do not freely permit the Debtors to sell or transfer PII to a third party. Accordingly, in connection with her recommendations set forth herein, the Ombudsman is providing the Bankruptcy Court with information, pursuant to section 332(b) of the Bankruptcy Code, to assist the Bankruptcy Court in (a) considering the facts, circumstances, and condition of a proposed sale of PII, and (b) evaluating whether a sale of PII violates applicable nonbankruptcy law.

Applicable Nonbankruptcy Law

19. The Ombudsman has determined that the following nonbankruptcy laws¹⁰ are potentially applicable to the Sale: (a) Section 5 of the Federal Trade Commission Act¹¹ (the "FTC Act"); (b) the Children's Online Privacy Protection Act of 1998¹² ("COPPA"); (c) the Gramm-Leach-Bliley Act¹³ ("GLBA"); and (d) applicable state consumer protection laws.

⁹ See 11 U.S.C. § 363(b)(1)(B).

¹⁰ The Debtors are not engaged in the sale of prerecorded video cassette tapes or similar audio visual materials and thus The Video Privacy Protection Act 1988 ("VPPA") has not been considered. 18 U.S.C. § 2710.

¹¹ 15 U.S.C. §§ 41-58, as amended.

¹² 15 U.S.C. § 6501, *et seq.* (2006); 16 C.F.R. § 312 (2006). *See also* Children's Online Privacy Protection Rule, Final Rule, 64 Fed. Reg. 59888 (Nov. 3, 1999) (explaining basis and purpose of the Act).

¹³ 15 U.S.C., Subchapter 1, § 6801-6809 (1999).

The Federal Trade Commission Act

20. The FTC has general authority to issue regulations to implement protections against unfair and deceptive acts and practices.¹⁴ Section 5 of the FTC Act directs the FTC to prevent persons and corporations from using “unfair or deceptive acts or practices in or affecting commerce.”¹⁵ Specifically, unfair acts or practices includes conduct that (a) causes substantial consumer injury; (b) is not outweighed by countervailing benefits to consumers or competition; and (c) results in an injury that consumers could not reasonably have avoided.¹⁶ Deceptive acts or practices focus on whether a misrepresentation or omission is likely to mislead consumers acting reasonably under the circumstances to their detriment.¹⁷ Specifically, to be deceptive, conduct (a) must be conveyed through either express or implied claims, (b) must be likely to mislead reasonable consumers, and (c) must be material^{18, 19}

21. The FTC has interpreted Section 5 of the FTC Act as prohibiting an entity’s collection, use, or disclosure of PII in a manner that is contrary to a promise made to consumers in its privacy policy, including a promise not to share such information with third parties.²⁰

¹⁴ 15 U.S.C. § 57A.

¹⁵ 15 U.S.C. § 45(a)(1).

¹⁶ 15 U.S.C. § 45(n).

¹⁷ See FTC Policy Statement on Deception, appended to *Cliffdale Associates, Inc.*, 103 F.T.C. 110, 174 (1984) available at <https://www.ftc.gov/public-statements/1983/10/ftc-policy-statement-deception>.

¹⁸ A representation is material if a “reasonably prudent person” would “usually” rely on it, or it is “likely to affect the consumer’s conduct or decision with regard to a product or service.” *FTC v. Transnet Wireless Corp.*, 506 F. Supp. 2d 1247, 1266 (S.D. Fla. 2007).

¹⁹ See *FTC v. Freedom Commc’ns, Inc.*, 401 F.3d 1192, 1203 (10th Cir. 2005); *FTC v. Tashman*, 318 F.3d 1273, 1277 (11th Cir. 2003); *FTC Policy Statement on Deception*, *supra* note 23.

²⁰ See *In re GeoCities, Inc.*, 127 F.T.C. 94 (1999) (consent order settling charges that website had misrepresented the purposes for which it was collecting PII); see also *United States v. ChoicePoint, Inc.*, Stipulated Final Judgment and Order (N.D. Ga. 2006); *In the Matter of Vision I Properties d/b/a CartManager International*, Agreement Containing Consent Order (FTC 2004), www.ftc.gov/os/caselist/0423068/050310agree0423068.pdf; *In the Matter of Petco Animal Supplies, Inc.*, Decision and Order (FTC 2005), www.ftc.gov/os/caselist/0323221/050308do0323221.pdf; *In the Matter of Gateway Learning Corp.*, Decision and Order (FTC 2004), www.ftc.gov/enforcement/cases-andproceedings/cases/2004/12/gateway-learning-corp-matter; *In the Matter of Tower Records*, Decision and Order (FTC 2004),

Section 5 of the FTC Act, as enforced by the FTC, could, without adoption of the Toysmart criteria, as discussed below, prohibit the Debtors from transferring consumer data, including PII, to the Buyer, as doing so is contrary to the Debtors' privacy representations and could be deemed a deceptive trade practice.²¹

22. Recognizing that a consumer's privacy rights must be balanced with the best interests of a debtor's estate and creditors in a bankruptcy proceeding, the FTC, in connection with the Toysmart bankruptcy case, consented to the debtor's proposed sale of PII (which was in contravention of the Toysmart privacy policy), so long as the debtor was selling the PII as part of a larger asset sale and the purchaser agreed to (a) operate as a going concern, and or concentrated in the same business or market as the debtor; (b) expressly agreed to be bound by and succeed to the debtor's existing privacy policies; (c) agreed to be responsible for any violation of existing privacy policies; and (d) agreed that prior to making any material change to the debtor's existing privacy policies, obtained affirmative (opt-in) consumer consent.²² The Toysmart settlement has become the benchmark used by the FTC when evaluating whether PII may be sold notwithstanding provisions to the contrary in a company's privacy policy. Similarly, bankruptcy

www.ftc.gov/os/caselist/0323209/040602do0323209.pdf; In the Matter of Guess?, Inc. and Guess.com, Inc., Decision and Order (FTC 2003), www.ftc.gov/os/2003/06/guessagree.pdf; In the Matter of Educational Research Center of America, Inc. and Student Marketing Group, Inc., Decision and Order (FTC 2002), www.ftc.gov/os/2003/01/ercaconsent.htm; In the Matter of the National Research Center for College and University Admissions, Inc., Decision and Order, (FTC 2003) www.ftc.gov/os/2003/01/nrccuamuncedo.htm; In the Matter of Microsoft Corporation, Decision and Order (FTC 2002), www.ftc.gov/sites/default/files/documents/cases/2002/12/microsoftdecision.pdf; In the Matter of Eli Lilly and Company, Decision and Order (FTC 2002), www.ftc.gov/os/2002/05/elilillydo.htm; FTC v. Reverseauction.com, Inc., Decision and Order (FTC 2000), www.ftc.gov/os/2000/01/reverseconsent.htm; In the Matter of Liberty Financial Co., Decision and Order (FTC 1999), www.ftc.gov/os/2000/01/reverseconsent.html.

²¹ See Stipulation and [Proposed] Order Establishing Conditions on Sale of Customer Information, In re Toysmart.com, LLC, Civil Action No. 00-13995-CJK (Bankr. E.D. Mass. 2000), www.ftc.gov/sites/default/files/documents/cases/toysmartbankruptcy.

²² Id.

courts have relied on the criteria set forth in Toysmart when determining whether a sale complies with the Bankruptcy Code and applicable non-bankruptcy law.²³

23. As the Debtors' Privacy Policies and the Toysmart privacy policy both contain similar limitations on the use and disclosure of PII, the Ombudsman recommends that, given the facts and circumstances of this case, the Court follow the guidelines developed in Toysmart with certain modifications as set forth herein to account for issues unique to the Debtors' data collection practices and procedures.

Children's Online Privacy Protection Act

24. In addition to the FTC Act, COPPA prohibits unfair or deceptive acts or practices in connection with the collection, use, or disclosure of PII from and about children under the age of 13 obtained from the Internet.²⁴ COPPA requires that companies that collect information from children provide notice on their websites concerning what information they collect, how they will use that information and what disclosure practices will apply to that information.²⁵ Pursuant to the FTC's rules interpreting COPPA, a company must, among other things, obtain parental consent "to any material change in the collection, use, and/or disclosure practices to which the parent has previously consented."²⁶

25. The Debtors provided no information to the Ombudsman suggesting that the Debtors knowingly collected personal information from children under the age of 13.

26. As a result, there is no evidence that the Debtors are not in compliance with the requirements of COPPA.

²³ See, footnote 7 *infra*.

²⁴ 15 U.S.C. § 6501, *et seq.* (2006); 16 C.F.R. § 312 (2006). See also Children's Online Privacy Protection Rule, Final Rule, 64 Fed. Reg. 59888 (Nov. 3, 1999) (explaining basis and purpose of the Act).

²⁵ 15 U.S.C. § 6502(b)(1)(A) (2006); 16 C.F.R. § 312.3 (a) (2006).

²⁶ 16 C.F.R. § 312.5(a) (2006).

Gramm-Leach-Bliley Act

27. Title V, Subtitle A of the GLBA governs the treatment of non-public personal information about consumers by domestic financial institutions. Subject to certain exceptions, the GLBA prohibits a financial institution from disclosing nonpublic personal information concerning consumers to nonaffiliated third parties, unless the financial institution satisfies certain notice and opt-out requirements, and provided that the consumer has not elected to opt-out of the disclosure.

28. While the Debtors are not a “financial institution” under the GLBA, the FTC’s interpretation of the GLBA is instructive. Specifically, in connection with the FTC’s consideration of its Privacy of Consumer Financial Information Rule, the FTC interpreted the GLBA as not requiring new initial (and opt-out) notices in situations in which the surviving entity adopts the policies and practices of the acquired entity. This interpretation is consistent with the FTC’s stipulation and decree in Toysmart and is helpful to the Ombudsman’s analysis of the Sale. Therefore, as long as the Buyer meets the criteria of a Qualified Buyer and subject to the other recommendations that take into account the unique facts and circumstances of this case, the Ombudsman recommends that a notice and opt-out choice standard is appropriate.

Applicable State Laws

29. All 50 states and the District of Columbia have adopted their own, similar consumer protection statutes.²⁷ Since the Individual Customer Information contains the PII of

²⁷ See, e.g., Alabama, Ala. Code § 8-19-1 et seq.; Arizona, Consumer Fraud Act, A.R.S. §§ 44-1521-44-1534; California, Cal. Bus. & Prof. Code § 17200 et seq.; Connecticut, Conn. Gen. Stat. § 42-110a et seq.; Colorado, Colorado Revised Statute § 6-1-105 (e); Delaware, Del. Code Ann. tit. 6, § 2511 et seq.; Florida, Fla. Stat. § 501.201 et seq.; District of Columbia, Consumer Protection Procedures Act, D.C. Code §§ 28-3901 et seq.; Hawaii, Haw. Rev. Stat. § 487; Idaho, Consumer Protection Act, Idaho Code § 48-601 et seq.; Illinois, 815 Ill. Comp. Stat. Ann. §§ 505/1 et seq.; Indiana, Deceptive Consumer Sales Act, Indiana Code sec. 24-5-0.5-3(a) and (b)(1); Iowa, Consumer Fraud Act, Iowa Code § 714.16; Kentucky, Ky. Rev. Stat. Ann. §§ 367.110-367.300; Maryland, Maryland Consumer Protection Act, Md. Code Ann., Com. Law § 13-101 et seq.; Massachusetts, Massachusetts Consumer Protection Act, Mass. Gen. Laws c. 93A, § 2(a) and the regulations promulgated

consumers in all U.S. States, the Debtors are required to comply with State Consumer Protection Acts, where applicable. While there is some variation among the various state laws, most, if not all, prohibit deceptive representations to consumers. As such, a debtor must comply with these applicable non-bankruptcy laws when selling or transferring PII.²⁸ The analysis of the Debtors' sale of PII under state law would be substantially similar to the analysis of the FTC Act discussed above.

Other Considerations

30. Section 332(b) of the Bankruptcy Code provides that the Ombudsman shall “provide to the court information to assist the court in its consideration of the facts, circumstances, and conditions of the proposed sale or lease of PII under section 363(b)(1)(B).”²⁹ Among other things, the Ombudsman may present the following information to the Court:

- a. the Debtors' Privacy Policies;
- b. the privacy impact on consumers if the sale proceeds; and
- c. alternative solutions that might mitigate the privacy impact.³⁰

thereunder, 940 CMR 3.00 et seq. and 6.00 et seq.; Michigan, Mich. Comp. Laws §445.911 et seq.; Minnesota, Minn. Stat. § 325D.44-.48; Mississippi, Mississippi Consumer Protection Act, Miss. CODE ANN. §§ 75-24-1, et seq.; Missouri, § 407.020 of the Missouri Merchandising Practices Act; Montana, Mont. Code Ann. § 30-14-133 et seq.; Nebraska, Nebraska Consumer Protection Act, Neb. Rev. Stat. § 59-1601 et seq.; Nevada, Nev. Rev. Stat. § 598.0915(5); New York, N.Y. Gen. Bus. Law § 349 et seq.; North Carolina, N.C. Gen. Stat. 75-1.1; Ohio, Consumer Sales Practices, Ohio Rev. Code Ann. §§ 1345.01 et seq.; Oklahoma, Oklahoma Consumer Protection Act, 15 O.S. § 751 et seq.; Oregon, Or. Rev. Stat. §§ 646.605 et seq.; Pennsylvania, Pennsylvania Unfair Trade Practices and Consumer Protection Law, 73 P.S. § 201-1, et seq.; South Carolina, South Carolina Unfair Trade Practices Act, §§ 37-20-190(A), 39-5-20(a), Section 39-5-10(b); South Dakota, S.D. Codified Laws § 37-24-1 et seq.; Tennessee, Consumer Protection Act, T.C.A. § 47-18-102 et seq.; Utah, Utah Code Ann. § 13-11-1 et seq.; Virginia, Virginia Consumer Protection Act, Virginia Code §§ 59.1-196 through 59.1-207; Washington, Washington Consumer Protection Act, RWC 19.86.020, West Virginia, West Virginia Consumer Credit & Protection Act, W. Va. Code §§ 46A-1-101 et seq.; Wisconsin, Wis. Stat. § 100.18.

²⁸ See Handling Customer Data in Bankruptcy Mergers and Acquisitions-Coping with the Consumer Privacy Ombudsman Provisions of the 2005 Bankruptcy Act, Warren Agin, 60 Consumer Fin. L.Q. Rep. 609 (2006).

²⁹ See 11 U.S.C. 363(b)(1)(B).

³⁰ See 11 U.S.C. § 332(b).

The Debtors' Privacy Policies

- The Debtors' Privacy Policies are silent on whether the Debtors may sell or transfer consumer's PII. However, there are other limitations in the Privacy Policies, which suggest that consumers did not anticipate a sale or transfer of their PII when such information was provided to the Debtors. Moreover, the Debtors appear to be aware of this limitation as no marketing was done to consumers who were solely members of the Marbles Loyalty program. Specifically, the Debtors represented that they would only collect PII with the objective of fulfilling those purposes specified by the Debtors and for other compatible purposes and that such PII would only be retained for as long as necessary for the fulfillment of those purposes. However, despite these limitations, a court may approve a sale of PII in contravention of a privacy policy if (a) consent is obtained from each customer, or (b)(i) the Consumer Privacy Ombudsman process is followed, and (ii) the bankruptcy court finds that applicable non-bankruptcy law has not been violated.³¹

Privacy Impact on Consumers if the Sale Proceeds

31. To the extent the Buyer operates or will operate a similar business or line of business as the Debtors, there will be a relatively seamless transition for consumers. But, the scope of PII to be transferred should be limited to those consumers who consented to receiving marketing materials from the Debtors. Specifically, the Buyer does not intend to continue the Loyalty Program. Accordingly, permitting the transfer of consumer PII collected solely in connection with the Marbles Loyalty program would not be consistent with consumer expectations and this information should not be transferred. It is important to note that under the Fair Information Practice Principles, widely-accepted principles concerning fair information

³¹ See 11 U.S.C. 363(b)(1)(B).

practices that govern the collection, use and transfer of PII, personally identifiable information should only be used for the purpose for which it was collected and retained only as long as necessary to fulfill that stated purpose. It is on this basis that the Ombudsman recommends that all PII collected under the Marbles Loyalty program be excluded from the Sale as it both violates the Debtors' Privacy Policies and is inconsistent with the information life cycle. The Ombudsman further recommends that the Buyer agree to be bound by the Debtors' Privacy Policies and use PII only in a manner consistent with those policies. These protections, coupled with the other recommendations contained in this Report, are intended to minimize the impact on consumers if the Sale of Individual Customer Information is approved by the Court.

Alternative Solutions that Might Mitigate the Privacy Impact

32. In light of the Debtors' Privacy Policies, the Ombudsman has considered various alternative solutions that might mitigate the privacy impact on consumers if the Sale is approved to the Buyer. Among the factors considered in formulating the recommendations in this Report were (a) the sensitivity of the data collected; (b) the general reliability of the PII collected; (c) the costs and benefits associated with requiring affirmative consent to the Sale from consumers; (d) the appropriate scope of Individual Customer Information to be transferred; and (e) the potential relevance of the Individual Customer Information and associated PII to the Buyer.

33. The consumer information collected by the Debtors is not of a sensitive nature. Most of this information is available from public sources. Moreover, the Debtors are not seeking authority to sell financial information or credit or debit card numbers, which minimizes any risk of identity theft associated with the Sale. In the Ombudsman's opinion, the PII at issue here does not rise to the level of requiring affirmative opt-in consent to the Sale. However, the scope of the PII to be transferred should be limited to only those consumers who opted-in to the receiving marketing materials.

The Buyer is a “Qualified Buyer”

34. It is the Ombudsman’s understanding that the Buyer is a leading global, diversified, multi-platform and highly innovative children’s entertainment company. Based upon a review of the Buyer’s website, product mix, and focus, the Ombudsman is of the opinion that the Buyer is a “Qualified Buyer” under the Toysmart criteria.

CONCLUSION

35. In summary, the Ombudsman believes that the recommendations in this Report, if incorporated in any order approving the Sale, strike an appropriate balance between the privacy rights of consumers and practical considerations associated with the sale of the Individual Customer Information.

Dated: New York, New York
April 24, 2017

RESPECTFULLY SUBMITTED,



Elise S. Frejka, CIPP/US
Consumer Privacy Ombudsman

CERTIFICATE OF SERVICE

I, Elise S. Frejka, an attorney, state that pursuant to Local Rule 9013-1(D) the above Report of the Consumer Privacy Ombudsman was filed on April 24, 2017, and served on all parties identified as Registrants on the service list below through the Court's Electronic Notice for Registrants.

/s/ Elise S. Frejka
Elise S. Frejka

SERVICE LIST

Registrants Served Through the Court's Electronic Notice for Registrants:

Howard L. Adelman: hla@ag-ltd.com, dbaird@ag-ltd.com
Richard A. Bixter: richard.bixter@hklaw.com
Dustin P. Branch: branchd@ballardspahr.com, carolod@ballardspahr.com Michael
A. Brandess: mbrandess@sfggh.com, bkdocket@sfggh.com
Alexander F. Brougham: abrougham@ag-ltd.com
Erich S. Buck: ebuck@ag-ltd.com, lhope@ag-ltd.com
Shelly A. DeRousse: sderousse@freeborn.com, bkdocketing@freeborn.com;
jhazdra@ecf.inforuptcy.com
David R. Doyle: ddoyle@shawfishman.com, kjanecki@shawfishman.com Devon J.
Eggert: deggert@freeborn.com, bkdocketing@freeborn.com Jeffrey L. Gansberg:
jgansberg@muchshelist.com, nsulak@muchshelist.com Chad H. Gettleman:
cgettleman@ag-ltd.com, ts@ag-ltd.com
Emily S. Gottlieb: emily_gottlieb@gardencitygroup.com,
paul.kinealy@gardencitygroup.com;
PACERTeam@gardencitygroup.com
Allen J. Guon: aguon@shawfishman.com, cowens@shawfishman.com Timothy M.
Howe: tim@chicagolaw.biz
Elizabeth L. Janczak: ejanczak@freeborn.com, bkdocketing@freeborn.com Robert
J. Labate: robert.labate@hklaw.com
Patrick S. Layng: USTPRegion11.ES.ECF@usdoj.gov Matthew
Luzadder: mluzadder@kelleydrye.com,
KDWBankruptcyDepartment@KelleyDrye.com;
kkleist@kelleydrye.com; mvicinanza@ecf.inforuptcy.com
Daniel J. McGuire: dmcguire@winston.com, ECF_BANK@winston.com Henry
B. Merens: hbm@ag-ltd.com
David Nold: nuddin@noldmuchlaw.com, mfolsom@noldmuchlaw.com Kristen N.
Pate: ggpbk@ggp.com
M. Gretchen Silver: ustpreion11.es.ecf@usdoj.gov, gretchen.silver@usdoj.gov;
denise.delaurent@usdoj.gov; maria.e.yapan@usdoj.gov
Adam P. Silverman: asilverman@ag-ltd.com, tslack@ag-ltd.com
Jerry L. Switzer: jswitzer@polsinelli.com, chicagodocketing@polsinelli.com David P.
Vallas: DVallas@polsinelli.com

TABLE OF EXHIBITS

- Exhibit A Stipulation and [Proposed] Order Establishing Conditions on Sale of Customer Information, In re Toysmart.com, LLC, Civil Action No. 00-13995-CJK (Bankr. E.D. Mass. 2000)
- Exhibit B The Debtors' Web Site Terms, Conditions of Use and Privacy Policy in effect on the Petition Date (<http://www.marblesthebrainstore.com/Connect/privacy-and-terms.htm>)
- Exhibit C The Marbles Loyalty Terms, Conditions of Use and Privacy Policy in effect on the Petition Date (<http://www.marblesthebrainstore.com/Members/rewards-program-terms-conditions.htm>)