

UNITED STATES BANKRUPTCY COURT
DISTRICT OF NORTH DAKOTA

In re Case No.: 17-30112
VANITY SHOP OF GRAND FORKS, Chapter 11
INC.,
Debtor. /

CONSUMER PRIVACY OMBUDSMAN'S REPORT

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Luis Salazar, the duly appointed Consumer Privacy Ombudsman for the estate of Vanity Shop of Grand Forks, Inc. (“**Vanity Shops**” or “**Debtor**”), respectfully submits this Report to the Court and states:

I. Summary of Findings and Recommendations

1. Vanity Shops filed its Chapter 11 on March 1, 2017. On October 3, 2017, Vanity Shops filed *Debtor’s Motion for Entry of an Order, Pursuant to 11 U.S.C. §§ 105 and 363, (I) Approving Bid/Sale Procedures, (II) Authorizing the Sale of Certain Intellectual Property Free and Clear of Liens, Claims, Encumbrances, and Other Interests, and (III) Granting Related Relief* (Doc 430) (the “**Sale Motion**”), which, among other things, sought to sell certain intellectual property including customer files and related data, including contact information and email addresses, and other purchasing history and related information. Vanity Shops agreed that the Intellectual Property may contain “**Personally Identifiable Information**” or “**PII**” as that term is defined in Bankruptcy Code Section 101(41A)¹ (“**Customer PII**”). This proposed transfer of that data triggered the appointment of a consumer privacy ombudsman pursuant to Bankruptcy Code Section 332 and the submission of this Report.

¹Bankruptcy Code Section 101(41A) provides that the term “personally identifiable information” 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 of 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; or

(B) if identified in connection with 1 or more of the items of information specified in subparagraph (A)

- (i) a birth date, the number of a certificate of birth or adoption, or a place of birth; or
- (ii) Any other information concerning an identified individual that, if disclosed, will result in contacting or identifying such individual physically or electronically.

2. After review of the facts and circumstances of this proposed sale, and as more fully discussed in this Report, the Ombudsman respectfully recommends that the Court may approve the proposed sale and transfer of the Customer PII subject to the following conditions to be set forth in any sale order:

- Customer PII may be sold and transferred, provided that Vanity Shops demonstrates that such sale and transfer is to a “Qualified Buyer.” A “Qualified Buyer” means an entity that: (a) agrees to operate Vanity Shops’ as a going concern, (b) expressly agrees to be bound by and succeed to substantially similar terms as contained in Vanity Shops’ existing privacy policies; and (c) agrees to be responsible for any violation of existing privacy policies;
- The Qualified Buyer must agree to be bound by and substantially meet the standards established by Vanity Shops’ privacy policies, to maintain at least the same level of information security currently maintained by Vanity Shops and comply with applicable privacy laws and regulations governing the transfer, storage, maintenance, and access to Customer PII;
- Vanity Shops and the Qualified Buyer agree to provide notice to any consumer whose Customer PII is being sold and transferred. That notice may be provided by a posting on Vanity Shops’ website or in any initial contact email or communication;
- Vanity Shops and the Qualified Buyer agree to provide consumers with an opportunity to opt-out as part of the notification process, to the extent required by law; and
- The Qualified Buyer shall file a certification within 30 days confirming their compliance with the conditions the Court may impose, or the Court may direct the Ombudsman to file a final report confirming such compliance.

3. If for any reason the Customer PII is sold to any other entity that would not meet the requirements of “Qualified Buyer,” then the Court should require that:

- The purchaser must, at a minimum, agree to abide by or substantially meet the standards of Vanity Shops’ existing privacy policies;
- Vanity Shops and the purchaser must provide notice to any consumer whose PII it holds of the proposed transfer; and

- As part of the notification, Vanity Shops and such a purchaser must provide customers with the opportunity to opt-in to the transfer, or their information would not be transferred but instead be destroyed.

4. These proposed conditions are consistent with applicable precedent in this area, including Federal Trade Commission rulings and prior Consumer Privacy Ombudsman recommendations in other bankruptcy cases.

II. Scope and Bases of Ombudsman Investigation

5. On October 11, 2017, the Court entered its *Order Granting Motion to Approve Stipulation for Appointment of Consumer Privacy Ombudsman* (Doc 442), which ordered the appointment of a consumer privacy ombudsman pursuant to 11 U.S.C. § 332 in connection with Vanity Shops' Sale Motion. The Ombudsman conducted an investigation and submits this Report in accordance with Bankruptcy Code Section 332(b) 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).

6. In preparing this Report, the Ombudsman has, among other things, reviewed:

- Vanity Shops' privacy policies associated with www.vanity.com, and the rewards web-site pages, which were in effect on the Petition Date;
- Vanity Shops' rewards program pamphlets provided to customers at all Vanity Shops retail locations to enroll in the rewards program;
- Memorandum provided by Debtor and its professionals detailing the Debtor's Customer PII collection process and the type of Customer PII collected;
- Vanity Shops e-commerce site www.vanity.com;
- Other Vanity Shops privacy policies, terms and conditions, and web-site pages in effect during the year prior to the petition date, as available on Archive.org; and
- The relevant pleadings, including the *Declaration of Jill Motschenbacher in Support of Chapter 11 Petition and First Day Motions* (Doc 26) (the "**Declaration**") and the Sale Motion.

7. The Ombudsman interviewed representatives of the Debtor and Debtor's counsel in order to understand Debtor's process for obtaining Customer PII, and spoke with proposed buyer Vanity Brands, LLC ("**Vanity Brands**") to understand the nature of its business, as much as its intention with Vanity Shops assets.

8. Finally, the Ombudsman researched applicable Federal, State, and local laws and regulations regarding the privacy of consumer information, as necessary, and reviewed the outcome in comparable situations.

III. Background

9. **About Vanity Shops.** Founded in 1966, Vanity Shops is a North Dakota corporation headquartered in Fargo, North Dakota. Vanity Shops opened its doors for the first time in 1969 and was a regional specialty retailer of casual apparel and accessories for fashion-conscious young women. Vanity Shops owned and sold its own line of private-label goods, including private-label branded denim in approximately 137 mall-based stores spanning 27 states. Their fashions were also available through www.vanity.com, which was launched in 2008.

10. Vanity Shops sourced reasonably priced fashion apparel and accessories from U.S.-based suppliers and overseas manufacturers. At least 60% of Vanity Shops inventory originated with U.S. suppliers. Ecommerce products were distributed from a building located one mile from Vanity Shops' headquarters.

11. **Business Operations.** Shazzam! Inc., Vanity Shops' parent holding company, owns 100% of Vanity Shops stock. Shazzam! Inc.'s only asset was Vanity Shops stock. Vanity Shops employed 274 full-time and 1,049 part-time employees as of the date of filing its petition. All the administrative and management services including human resources administration, accounting/bookkeeping, marketing, IT support, product sourcing and design, training of store employees, etc. were provided by Vanity, Inc. pursuant to a management agreement. Vanity Shops' total sales in the year ending December 2016 were approximately \$80 million.

12. **Interview with Debtor.** As a part of the Ombudsman's obligation to investigate and research the sale of Vanity Shops' Customer PII, the Ombudsman held a telephonic conference with Debtor and Debtor's professionals to obtain an

understanding of the Debtor's business, the type of information collected from customers, and any and all privacy policies the Debtor had in place. Vanity Shops also provided the Ombudsman with an informational packet that clearly set forth how customer data was obtained, database maintenance, and the privacy policy in its entirety.

13. **Interview with Vanity Brands, LLC.** The Ombudsman also held a telephonic conference with Daniel Setton, a representative of the buyer, Vanity Brands. Vanity Brands informed the Ombudsman of its intention for the future of Vanity Shops. The Ombudsman was made aware that Vanity Brands has years of experience in this type of transaction and even more experience with legacy brands such as Vanity Shops. Vanity Brands is currently in the process of establishing an ecommerce platform for the Customer PII and is highly interested in preserving Vanity Shops' customer base and plans to continue to sell casual apparel and accessories, as Vanity Shops did.

IV. Assets for Sale

14. Vanity Shops and Vanity Brands, LLC executed an Asset Purchase Agreement ("**Purchase Agreement**") which contemplates the sale of Vanity Shops' Customer PII. Specifically, the Purchase Agreement provides for the sale and transfer of intellectual property under Section 5.9. Section 5.9 states:

Section 5.9 Intellectual Property.

(a) Schedule 2.1(a) lists all issued registered Trademarks included in the Acquired Assets. Except as noted on Schedule 5.9(a), all required filings and fees related to the registered Intellectual Property have been timely filed with and paid to the relevant Governmental Authorities and authorized registrars, and all Intellectual Property registrations are otherwise in good standing. Seller has provided Buyer with true and complete copies of file histories, documents, certificates, office actions, correspondence and other materials related to all such Intellectual Property registrations.

(b) Schedule 5.9(b) lists all Intellectual Property Agreements. Seller has provided Buyer with true and complete copies of all such Intellectual Property Agreements, including all modifications, amendments and supplements thereto and waivers thereunder. Each listed Intellectual Property Agreement is valid and binding on Seller in accordance with its terms and is in full force and effect. Neither the Seller nor, to Seller's Knowledge, is any other party thereto in breach of or default under (or is alleged to be in breach of or default under), or has provided or received any notice of breach or default of or any intention to terminate, any such Intellectual Property Agreement. No event or circumstance has occurred that, with notice or lapse of time or both, would constitute an event of default under any listed Intellectual Property Agreement or result in a termination thereof or would cause or permit the acceleration or other changes of any right or obligation or the loss of any benefit thereunder. For purposes of this Agreement, "Intellectual Property Agreements" means all licenses, sublicenses, consent to use agreements, settlements, coexistence agreements, covenants not to sue, permissions and other Contracts (including any right to receive or obligation to pay royalties or any other consideration), whether written or oral, relating to any Intellectual Property included within the Acquired Assets to which Seller is a party, beneficiary or otherwise bound.

(c) Seller is the sole and exclusive legal and beneficial, and with respect to the Intellectual Property registrations included within the Acquired Assets, record, owner of all right, title and interest in and to the Intellectual Property included within the Acquired Assets, in each case, free and clear of Encumbrances. The consummation of the transactions contemplated hereunder will not result in the loss or impairment of or payment of any additional amounts with respect to, nor require the consent of any other Person in respect of, the Buyer's right to own, use or hold for use any such Intellectual Property.

(d) Seller's rights in the Intellectual Property included within the Acquired Assets are valid, subsisting and enforceable. Seller has taken commercially reasonable steps to maintain such Intellectual Property and to protect and preserve the confidentiality of all trade secrets included in such Intellectual Property.

(e) The conduct of Seller's business as currently and formerly conducted, and the Intellectual Property included within the Acquired Assets and Intellectual Property licensed under the Intellectual Property Agreements as currently or formerly owned, licensed or used by Seller, have not infringed, misappropriated, diluted or otherwise violated, and have not, do not and will not infringe, dilute, misappropriate or otherwise violate, the Intellectual Property or other rights of any Person. To Seller's Knowledge, no Person has infringed, misappropriated, diluted or otherwise violated, or is currently infringing, misappropriating, diluting or otherwise violating, any Intellectual Property included within the Acquired Assets.

(f) There are no Claims (including any oppositions, interferences or re-examinations) settled, pending or threatened (including in the form of offers to obtain a license): (i) alleging any infringement, misappropriation, dilution or violation of the Intellectual Property of any Person by Seller in connection with its business; (ii) challenging the validity, enforceability, registrability or ownership of any Intellectual Property included within the Acquired Assets or Seller's rights with respect to any such Intellectual Property; or (iii) by Seller or any other Person alleging any infringement, misappropriation, dilution or violation by any Person of any such Intellectual Property. Seller is not subject to any outstanding or prospective Order (including any motion or petition therefor) that does or would restrict or impair the use of any such Intellectual Property.

(g) Schedule 5.9(g) identifies and describes each distinct electronic or other database containing (in whole or in part) Personal Data related to the Acquired Assets maintained by or for Seller at any time ("Seller Databases"), the types of Personal Data in each such database, the means by which the Personal Data was collected, and the security policies that have been adopted and maintained with respect to each such database. Except as described in Schedule 5.9(g), no material breach of violation of any such security policy has occurred in the past two (2) years or is occurring or, to the Knowledge of Seller, is threatened, and in the past two (2) years there has not been, nor is there currently any unauthorized or illegal use of or access to any of the data or information in any of the Seller Databases. Except as set forth on Schedule 5.9(g), Seller has complied at all times and in all material respects with all of Seller's privacy policies and with all applicable Laws pertaining to privacy or Personal Data. For purposes of this Agreement, "Personal Data" means a natural person's name, street address, telephone number, email address, photograph, social security number, driver's license number, passport number or customer or account number or any other piece of information that allows the identification of a natural person.

Section 5.9, Asset Purchase Agreement dated October 25, 2017.

15. Further, the Purchase Agreement includes the following covenants by Vanity Brands under Article VII:

ARTICLE VII ACTIONS PRIOR TO THE CLOSING DATE

Section 7.1 Operations Prior to the Closing Date. Seller covenants and agrees that, except (i) as expressly contemplated by this Agreement, (ii) with the prior written consent of Buyer (which consent, other than with respect to Section 7.1(b)(ii), shall not be unreasonably withheld or delayed), (iii) as required by the Bankruptcy Court or (iv) as otherwise required by Law, after the Effective Date and prior to the Closing Date:

(a) Seller shall use commercially reasonable efforts, taking into account Seller's status as a debtor-in-possession in the Bankruptcy Case, to maintain and preserve the Acquired Assets in their present condition and, without limiting the generality of the foregoing,

(b) Seller shall not:

(i) sell, lease (as lessor), transfer or otherwise dispose of, or mortgage or pledge, or voluntarily impose or suffer to be imposed any Encumbrance (other than assumed liabilities and Permitted Encumbrances) on, any Acquired Asset;

(ii) cancel or compromise any material claim or waive or release any material right, in each case, that is a claim or right related to an Acquired Asset, or enter into any agreement or commitment to take any action prohibited by this Section 7.1.

Section 7.2 Bankruptcy Court Filings and Approval.

(a) Seller shall use Seller's commercially reasonable efforts to obtain entry of the Sale Order and such other relief from the Bankruptcy Court as may be necessary or appropriate in connection with this Agreement and the consummation of the transactions

contemplated by this Agreement including, to the extent required, the retention of a Consumer Privacy Ombudsman. Buyer agrees that it will promptly take such actions as are reasonably requested by Seller to assist in obtaining entry of the Sale Order and, consistent with Section 2.4, a finding by the Bankruptcy Court that Buyer in acquiring the Acquired Assets Buyer is entitled to a finding that it is a good faith purchaser within the meaning of Section 363(m) of the Bankruptcy Code. As soon as reasonably practicable after the parties execute this Agreement, but in any event no later than five (5) Business Days after the parties execute this Agreement, Seller shall file the Sale Motion with the Bankruptcy Court together with required supporting papers and required notices.

(b) Seller and Buyer acknowledge that this Agreement and the sale of the Acquired Assets are subject to Bankruptcy Court approval. Seller and Buyer acknowledge that to obtain such approval, Seller must demonstrate that they have taken reasonable steps to obtain the highest or otherwise best offer possible for the Acquired Assets and Buyer hereby agrees to provide all appropriate assurances thereof necessary in order to obtain the foregoing approvals.

(c) Seller shall give all notices required to be given by applicable Law, to all Persons entitled thereto, of all motions (including the motions seeking entry of the Sale Order), orders, hearings and other proceedings relating to this Agreement and the transactions contemplated hereby and thereby and such additional notice as ordered by the Bankruptcy Court or as Buyer may reasonably request. Seller shall promptly provide Buyer with copies of all communications from the Bankruptcy Court relating to the motions seeking entry of the Sale Order.

(d) In the event an appeal is taken or a stay pending appeal is requested, from the Sale Order, Seller shall immediately notify Buyer of such appeal or stay request and shall provide to Buyer promptly a copy of the related notice of appeal or order of stay. Seller shall also provide Buyer with written notice of any motion or application filed in connection with any appeal from or stay request in respect of such order. Seller and Buyer shall use each of their respective commercially reasonable efforts to defend such appeal or stay request and obtain an expedited resolution of such appeal.

(e) From and after the date hereof, Seller shall not take any action that is intended to, or fail to take any action the intent of which failure to act is to, result in the reversal, voiding, modification or staying of the Sale Order.

Article VII, Asset Purchase Agreement dated October 25, 2017.

16. The Ombudsman has reviewed the proposed Purchase Agreement, including the relevant sections above, pursuant to which Vanity Brands proposes to acquire substantially all of the Intellectual Property.

V. Debtors' Privacy Policies and Personal Information Collection Activities

17. Vanity Shops operated one primary e-commerce site – www.vanity.com. A review of that site indicates that the Debtor collects a variety of information as part of its market and sales efforts.

18. In connection with these activities, prior to March 2017, Vanity Shops' privacy policy advised that it collects personal information and used it to provide services to its customer, but expressly stated it would not share that information with third parties:

General Browsing

Vanity Shop of Grand Forks, Inc. collects technical and navigational information when our visitors shop the Vanity.com website. This information allows the Vanity team to see which areas are most visited while helping create a better understanding of the needs of our shoppers. This information also helps us improve the quality of your online shopping experience by recognizing and delivering more of the features, services and products from previous visits by other shoppers. During the process of gathering navigational information, non-personally identifiable information (i.e. domain type, browser version, service provider and IP address) may be collected to provide information regarding a visitor's use of our website (such as the time of a visitor's last visit to a page on our website).

Collection, Use and Disclosure of Personal Information

We collect information from you that you provide to us at this website when you establish or update an account, enter a sweepstakes, participate in a survey, shop online or create or send a wish list. Categories of information collected include name, address, email address, recipient's email address, telephone number, credit card information and messages you create. This information is used to enable Vanity to deliver products that you have ordered, to fulfill requests that you have created, to contact you or the recipient(s) in the event of order or delivery difficulties, for verification, to respond to your inquiries and to deliver services and information about our products or website to you. We use third parties to help us provide services, such as processing payments, monitoring site activity, conducting surveys, maintaining our database, and administering and locating emails. If you opt into our email list through Vanity.com, some of the information you provide (for example, name, address, and email address) will be added to a database. Vanity may use that information for our own internal marketing purposes. We may request additional information from you to help us identify future options for you on our website. This information will be collected from you directly and openly. Using the information you give us, we may contact you with information or special offers. We will not require you to

disclose more information than is reasonably necessary to participate in an activity as a condition of participation. **Vanity Shop of Grand Forks, Inc. does not and will not sell or disclose personal information to outside third parties.** Vanity Shop of Grand Forks, Inc. will continue to strive to maintain compliance with legal regulations. If we become aware of or have a good faith belief that we must disclose information about you in connection with an investigation of fraud, intellectual property infringement, piracy, or other unlawful activity, we will disclose specific information about you to the appropriate legal authorities in order to protect the users of our Website, the site, and/or the public.

Privacy Policy for Minors

Our relationship with guests of all ages is very important. We welcome parents and their children to explore our site together and participate in our online drawings, free email newsletters, games, shopping and other promotional activities. In accordance with the Children's Online Privacy Protection Act, we will not gather or use personal information from any guest who indicates he or she is less than 13 years of age. If we become aware that we've gathered personal information from a minor, we will remove that information from our records immediately

Using Cookies

Vanity Shop of Grand Forks, Inc. uses a browser feature known as a cookie, which is placed on your computer. Cookies are small amounts of data that are transferred to your computer by our server. The cookies are stored on your computer's hard drive and are used by Vanity Shop of Grand Forks, Inc. to help track your clicks and pass information as you go through the pages within the Vanity.com website. Vanity Shop of Grand Forks, Inc. also uses cookies to help keep track of how many items you put into your shopping bag and to tell us whether you have previously visited Vanity.com. Cookies allow Vanity Shop of Grand Forks, Inc. to make our site more responsive to your needs, by delivering a better and more personalized experience to you. Most browsers automatically accept cookies. We do not recommend you disable your cookies.

We also use a technology known as clear gifs, which are typically stored in emails, to help us confirm your receipt of, and response to, our emails and to provide you with a more personalized experience. If you purchase product on Vanity.com, we may associate navigational information from your previous browsing visits with the personal information you provide. In addition, we carefully select third party advertising companies and allow them to collect non-personally identifiable information by placing cookies when you choose to visit Vanity.com. This information is used to report marketing program effectiveness directly back to Vanity Shop of Grand Forks, Inc. This information is used in aggregate form and is not in any way personally identifiable. We currently utilize Google Analytics. This service assists us in better understanding your use of our website. Google Analytics will place cookies on your computer to collect information on our behalf that will educate us on such things as search engine referral, how you navigate around our site, responses to email, unique visitor identification, and product browsing and purchasing information. Vanity Shop of Grand Forks, Inc. does not allow Google Analytics to collect credit card, username or password information. Google Analytics analyzes the information it collects on our behalf and the information and analysis is used to assist us in better understanding your interests in our website and how to better serve those interests and provide you with more personalized product offerings.

Links

For your convenience, our website may contain links to other sites. Vanity Shop of Grand Forks, Inc. is not responsible for the privacy practices or the content of such websites.

Our Email List

Joining Vanity Shop of Grand Forks, Inc.'s email list allows you to receive exclusive information about special offers, media events, new products and much more. If you're not already registered, simply complete our sign-up form to receive these special messages. You may also opt-in to our email database through our physical stores at the cash register. If you have opted-out of our email database in the

past but have more recently opted back into our email database through the store register, we will renew your subscription at that time. If at any time you would like to stop future delivery of Vanity.com email messages, please follow the removal instructions located at the bottom of each email message. This will not prevent you from receiving email communications relating to any online order you place on Vanity.com, requests to participate in surveys about our products or other operational email communications.

Questions or Changes in Policy

This Privacy & Security Policy applies only to the information collected online on Vanity.com. If you have questions or concerns with respect to our Privacy & Security Policy, please feel free to contact us by email: info@vanity.com or via US mail: Vanity.com Attention: Policies Manager, 2222 7th Ave N, Unit 100, Fargo, ND 58102. Should there be any changes in the categories of information collected on Vanity.com or any of the services we utilize to enhance your online experience or any changes in how we use information collected by Vanity Shop of Grand Forks, Inc. we will note changes as [Revised] at the beginning and end of the revised sentence or sentences for a period of 30 days from the effective date of the change and update the effective date at the bottom of the Privacy & Security Policy. If you are concerned about how your personal information is used, please visit our site often for this and other important announcements about Vanity Shop of Grand Forks, Inc. All of our services are opt-in. You will always have the opportunity to opt-out of these services at any time.

Security Statement

Security is a top priority at Vanity Shop of Grand Forks, Inc. We have made every effort and will continue to expand our abilities to ensure that the information transmitted to us online is secure. We expect that the person whose name appears on the credit card or payment service is the one who is placing the order. Vanity Shop of Grand Forks, Inc. uses secure sockets layer (SSL) encryption for securing

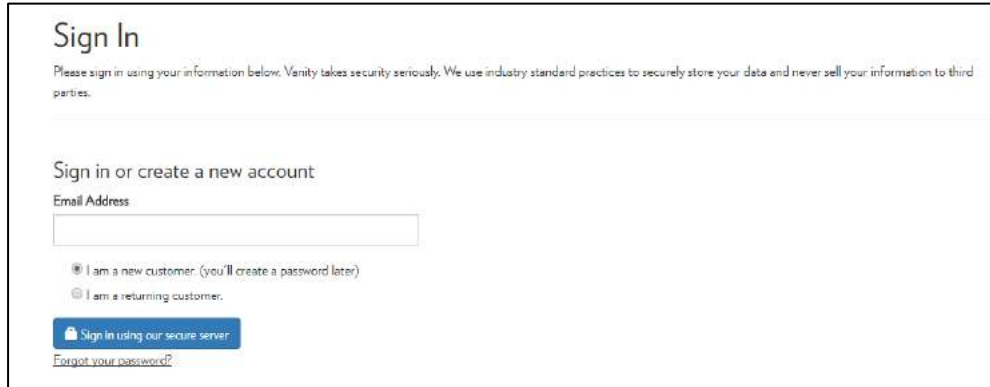
communications and transactions across the Internet. The SSL protocol uses digital certificates to create and secure confidential communications between the purchaser and our web entity. Data transmitted over an SSL connection cannot be tampered with or forged without the two parties becoming immediately aware of the tampering. A key or padlock icon will be shown in the lower corner of most browser windows to identify the security mode of a browser (for Internet Explorer 7.0 and higher, the padlock will be shown to the right of the address line). When the browser is running in normal mode, the key looks broken or the padlock looks open (for Internet Explorer 7.0 and higher, the padlock will not be shown if you are not within a secure area). Once an SSL connection has been established, the key becomes whole, or the padlock becomes closed, indicating that the browser is in secure mode. SSL is supported in the vast majority of browsers, which means that almost anyone with a browser can benefit from SSL encryption. In addition, it is our policy not to send your credit card number via email. In fact, this is a practice we recommend you adopt in all of your Internet activities. While we implement the above security measures on this site, you should be aware that achieving 100% security is not always possible.

Privacy Policy (October 23, 2016), *available at* <https://web.archive.org/web/20161023144608/http://www.vanity.com/privacy-policy> (last visited November 2, 2017)(emphasis added).

19. This privacy policy became, and was at the time of filing, the only privacy policy for both in-store and online registration for Vanity Shops' membership and rewards program.

20. The Ombudsman was advised that the sole vehicle for collecting Customer PII was either in-store at checkout or through registration for the rewards program.

21. Vanity Shops collected Customer PII primarily from its retail stores until the launch of their website (www.vanity.com) in 2008, which allowed members to join the rewards program. A snapshot of the member online enrollment below was captured by www.Archive.org on March 19, 2015.



22. The statement in the above snapshot and the privacy policy under paragraph 16 above both appear to state that Customer PII would never be sold to third parties.

VI. Applicable Law

23. This Report analyzes applicable law in three categories – relevant Bankruptcy Code provisions, other applicable Federal law, and applicable state laws.

A. The Consumer Privacy Ombudsman Provisions

24. **The Privacy Policy Enforcement in Bankruptcy Act (“PPEBA”) (Bankruptcy Code Sections 363(b)(1) and 332).** In 2001, the Leahy-Hatch Amendment, also known as the PPEBA, was added to the pending Bankruptcy Abuse Prevention and Consumer Protection Act. Generally, the PPEBA defined protected “personally identifiable information” in Section 101(41A), added restrictions to the sale of private consumer data under Section 363(B)(1), and created a consumer privacy ombudsman to aid courts in enforcing the new restrictions. PPEBA represents several “firsts” – the first national law that directly addresses enforcement of privacy policies and the first law to create an ombudsman to “enforce” a privacy policy law.

25. **Consumers and Privacy Policies.** As the internet grew in the late 90's, websites, especially e-commerce concerns, routinely asked for personal information from surfing visitors. Reflecting an understandable naiveté, many internet users initially provided private, personal information. But as the internet expanded, consumers grew more concerned about the potential use and misuse of their critical financial information.

26. This lack of consumer confidence threatened to seriously hinder the growth of e-commerce. Online privacy policies started springing-up about the same time in response to consumer concerns that their information could be misused. Privacy policies are essentially disclaimers that generally inform site users about whether or how their personal information is used or shared both within the company itself and with third parties, including related companies. In fact, several organizations, like TRUSTe, arose at the same time to give their “seal of approval” of a site’s privacy policies.

27. **The Conflict Between Privacy and Insolvency.** As dotcoms began failing, the Federal Trade Commission’s (“FTC”) interest in online privacy grew. Relying upon its general powers to protect consumers from unfair or deceptive business practices and the strong child-privacy protective provisions of the Children’s Online Privacy Protection Act (“COPPA”), the FTC was seeking an opportunity to flex its online muscle.

28. At the same time, investors and creditors were seeking to salvage investments in dotcoms, often by seeking to monetize and liquidate any available asset. It became quickly apparent that consumer information was at the heart of many online businesses’ value. See Hal F. Morris, et al., *Texas Attorney General: Privacy is Not for Sale*, Am. Bankr. Inst. J. (Oct. 2000) (discussing the conflict between the privacy rights of consumers and the interests of creditors).

29. Toysmart had the misfortune of standing at the crossroads when maximizing asset value and maximizing privacy collided. Toysmart’s business model was simple – sell educational toys online. But like so many internet companies, its model failed and it was forced to seek protection from its creditors. As part of its Plan of Liquidation, Toysmart sought to sell all of its assets, especially the personally-

identifying information of consumers, including many children. But this directly contravened its express privacy policy, which unequivocally promised consumers that: “Personal information voluntarily submitted by visitors to our site ... is never shared with a third party.”

30. **The Federal Trade Commission Steps In.** The FTC viewed the bankruptcy sale effort as a deceptive business practice – transferring private data despite the express promise not to do so – and a violation of COPPA. Relying on the police powers exception to the Automatic Stay, the FTC sued Toysmart in Federal District Court to enjoin any sale. Thirty-five states’ attorneys general filed similar suits in their home states.

31. The Toysmart Stipulation and Settlement establishes the “benchmark” that the FTC uses to determine whether a transfer of assets complies with a company’s privacy policy. For the Court’s convenience, a true and correct copy of the Toysmart Stipulation and Settlement is attached hereto as **Exhibit “A.”**

32. First, the FTC and Toysmart agreed that Toysmart would only sell the PII it held as part of the sale of its “goodwill” and only to a “Qualified Buyer” approved by the Bankruptcy Court. In turn, goodwill is defined as a group of assets consisting of Toysmart’s “right, title and interest in customer information, including contents of its customer-databases including detailed customer lists and related information, as well as names, trademarks, goodwill, URL names, web source codes, and data-based schemas without content and publishable contents located on its web site[.]”

33. Second, a “Qualified Buyer” means an entity that: (a) concentrates in the same business and market as Toysmart; (b) expressly agrees to be Toysmart’s successor-in-interest as to the customer information; (c) agrees to be responsible for any violation of Toysmart’s privacy policy following the date of purchase; (d) agrees it will use the PII only to fulfill customer orders and to personalize customers’ experience on the website; and (e) agrees it shall not disclose, sell, or transfer customers’ PII to any third party.

34. Finally, the Qualified Buyer must agree that any subsequent changes in the privacy policy will not be effective against a customer who's PII it holds, unless the customer receives notice and an opportunity to opt-in to the changed policy.

35. Despite this settlement with the FTC, Toysmart was not able to convince the various attorneys general to agree to the sale of PII under any terms. In the end, Toysmart withdrew the sale altogether and one of its equity owners, Disney, paid \$50,000 for the data and destroyed it.

36. The Toysmart case prompted many sites to carefully modify their privacy policies to allow the transfer of these types of assets. Nonetheless, the FTC found many additional targets - Living.com and Craftshop.com, to name a few - to enforce privacy policies. And state attorneys general pursued a similar action against eToys.

37. **PPEBA Addresses Narrow Privacy Policy Issue.** Drafted hot on the heels of the *Toysmart* case, PPEBA sought to address this inherent conflict between maintaining consumer privacy and maximizing assets by barring those sales, or allowing them only after careful examination by an independent party. In fact, in his opening floor statement on BAPCPA, Senator Leahy noted the need to address the *Toysmart* issue:

Unfortunately, the Leahy-Hatch amendment is needed because the customer lists and databases of failed firms now can be put up for sale in bankruptcy without any privacy considerations and even in violation of the failed firm's own public privacy policy against sale of personal customer information to third parties. That is wrong.

Toysmart.com, for example, a failed online toy store, filed for bankruptcy in 2000 and its databases and customer lists were put up for sale as part of the bankruptcy proceeding. This personal customer information was put on the auction block even though Toysmart.com promised on its web site that personal information voluntarily submitted by visitors to its site, such as name, address, billing information and shopping preferences, is never shared with a third party.

The Leahy-Hatch provision included in this legislation adds privacy protections and a Consumer Privacy Ombudsman to

the Bankruptcy Code to prevent future cases like Toysmart.com.

See Opening Floor Statement of Senator Patrick Leahy on BAPCPA of 2005, S. 256, Feb. 28, 2005.

38. In many respects, PPEBA incorporates components of the FTC's settlement with Toysmart.

39. **What Information is Protected?** Defining the information that needs protecting can be an exercise in futility – the more specific the definition, the more potentially identifying data slips out. Nonetheless, Bankruptcy Code Section 101(41A) defines “Personally Identifiable Information” as any data that allows an individual to be specifically identified, such as their name, address, email, telephone number, social security number, any birth-date information, credit card account information, or any other information which, if disclosed, would result in contacting or identifying an individual physically or electronically.

40. But the data must have been provided in connection with obtaining a product or a service from the debtor primarily for personal, family or household purposes. Under this restriction, purchased data, or data obtained by any other means, is simply not covered.

41. **Sale Restrictions in Section 363(b)(1).** Bankruptcy Code Section 363(b)(1) now limits the use, sale, or lease of personally identifiable information “if a debtor in connection with offering a product or a service discloses to an individual a policy prohibiting the transfer of personally identifiable information about individuals to persons that are not affiliated with the debtor and if such policy is in effect on the date of the commencement of the case.” If a non-ordinary course sale or use is contemplated, then this amended section requires in the first instance that it be consistent with the debtor's privacy policy.

42. If a non-consistent sale is nonetheless pursued, however, the Court must appoint a “Consumer Privacy Ombudsman” pursuant to Bankruptcy Code Section 332. After notice, a hearing, and recommendations from the ombudsman, the Court may approve the use, sale, or lease of the data after: (i) giving due consideration to the facts,

circumstances, and conditions of such sale; and (ii) finding that no showing was made that such sale or such lease would violate applicable non-bankruptcy law.

43. **The Ombudsman Duties.** The ombudsman’s duties include advising and assisting the Court in digesting the considerable facts and applicable privacy law that may come to play in any 363 sale of consumer data. The section specifically provides that the ombudsman may advise the Court on four key factors: (1) the debtor’s privacy policy; (2) the potential losses or gains of privacy to consumers if such sale or such lease is approved by the Court; (3) the potential cost or benefit to consumers if the transaction is approved; and (4) any potential alternatives that would mitigate potential privacy losses or potential costs to consumers.

B. Applicable Non-Bankruptcy Federal Law

44. **The Federal Trade Commission Act.** The primary enforcer of privacy policies on a national level is the FTC. Under Chapter 5 of the FTC Act, 15 U.S.C. §§ 41-58, the FTC is empowered, among other things, to: (a) prevent unfair methods of competition, and unfair or deceptive acts or practices in or affecting commerce; (b) seek monetary redress and other relief for conduct injurious to consumers; (c) prescribe trade regulation rules defining with specificity acts or practices that are unfair or deceptive, and establishing requirements designed to prevent such acts or practices; and (d) conduct investigations relating to the organization, business, practices, and management of entities engaged in commerce.

45. In determining whether a particular practice is unfair or deceptive, the FTC will consider both “express claims” and “implied claims” made by a company. An express claim is an assertion contained in a company’s public advertising, statements, or policies. An implied claim is the net impression conveyed by all elements of a company’s policies and statements. The FTC considers Chapter 5 to be violated when an express or implied claim is likely to affect a consumer’s choice of or conduct regarding a product and is likely to mislead reasonable consumers under the circumstances. Furthermore, an act or practice may be considered “unfair” if it causes, or is likely to cause, substantial injury to consumers that is not outweighed by

countervailing benefits to consumers or competition and is not reasonably avoidable by consumers.²

46. The FTC has used its broad authority to inject itself in a number of privacy disputes. In fact, as discussed above, it was the FTC's involvement in *In re Toysmart* that precipitated the passage of the Bankruptcy Code's Consumer Ombudsman provisions. To cite but a few additional examples, the FTC has also brought enforcement actions against Geocities for providing consumers with misleading information about how PII was collected and how it was used, and another against Guess?, Inc. for representing on its website that credit card and other information it obtained from consumers were secure, when they were in fact extremely vulnerable to hackers. State attorneys general have often "piggy-backed" on FTC actions because most states have enacted consumer protection laws that contain an FTC Act Chapter 5 variant.

47. In addition to the *Toysmart* case, perhaps the case most relevant to the circumstances here is *In the Matter of Gateway Learning Corp.*, (FTC File No. 04-2-3047). There, Gateway's privacy policy stated that "if at some future time there is a material change in our information usage practices that affect your personally-identifiable information, we will notify you of the relevant changes on this site or by e-mail. You will then be able to opt-out of this information usage[.]" The FTC filed a complaint against Gateway alleging that it violated its privacy policy by, among other things, unilaterally changing it to provide for the rental of personally identifiable information.

48. The parties ultimately reached a consent agreement that made clear that material changes in a privacy policy are not permitted, absent specific conditions. More specifically, the consent agreement mandates that, if Gateway decides to make a "material change" to its privacy policy, it would only apply to consumers or information

²See generally, FTC Policy Statement on Deception, *appended to Cliffdale Associates, Inc.* 103 F.T.C. 110, 174 (1984), available at www.ftc.gov/bcp/policystmt/ad-decept.htm (last visited May 9, 2014).

it collected before the change occurred, if Gateway obtains the express affirmative ‘opt-in’ consent of the consumers to whom such personal information relates.

49. **RadioShack.** The FTC weighed in on the potential sale of Customer PII in *RadioShack Corporation, et al.*, Case No. 15-10197 (BLS)(Bank. D. Del. 2015). There, the Debtor sought to sell customer PII under Privacy Policies that generally limited the sale of such information. The FTC submitted a letter to the appoint Consumer Privacy Ombudsman in that matter reemphasizing its position in *Toysmart*:

The Commission has brought many cases alleging that the failure to adhere to promises about information privacy constitute a deceptive practice under the FTC Act. These cases include *FTC v. Toysmart*, in which the Commission sued an online toy retailer which had filed for bankruptcy and sought to auction the personal information it collected from its customers. The Commission alleged that the sale of personal information constituted a deceptive practice because the company had represented in its privacy policy that such information would never be shared with third parties. We have similar concerns about the potential deceptive nature of the transfer of customer information in this case. We recognize, however, that bankruptcy presents special circumstances, including the interest in allowing a company to get back on its feet – or alternatively, to marshal remaining assets for its creditors – consistent with any promises made to customers. *Toysmart* is instructive on this point. There, the Commission entered into a settlement with the company allowing the transfer of customer information under certain limited circumstances: 1) the buyer had to agree not to sell customer information as a standalone asset, but instead to sell it as part of a larger group of assets, including trademarks and online content; 2) the buyer had to be an entity that concentrated its business in the family commerce market, involving the areas of education, toys, learning, home and/or instruction (i.e., the same line of business that *Toysmart* had been in); 3) the buyer had to agree to treat the personal information in accordance with the terms of *Toysmart*’s privacy policy; and 4) the buyer had to agree to seek affirmative consent before making any changes to the policy that affected information gathered under the *Toysmart* policy. These conditions served to protect consumer interests by ensuring that the data would be used consistent with *Toysmart*’s promises by an entity

that was essentially operating as a new owner of the business, as opposed to a “third party” who was merely the highest bidder in a winner-take-all auction that may not have a reputational interest in handling the information in the same manner. We believe the Toysmart precedent is an appropriate model to apply here to third parties. In this case, consumers provided personal information to RadioShack with the expectation that RadioShack might use it, for example, to make new offers of interest to consumers, but not to sell or rent it. As in *Toysmart*, our concerns about the transfer of customer information inconsistent with privacy promises would be greatly diminished if the following conditions were met:

- The customer information is not sold as a standalone 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.

As an alternative, we believe it would be appropriate for RadioShack to obtain affirmative consent from its customers before it transfers the data. The consent process would allow customers to make their own determination as to whether a transfer of their information would be acceptable to them. For consumers who do not consent, their data would be purged.

See May 16, 2015 FTC RadioShack Corporation Letter, **Exhibit “B.”**

C. Applicable State Laws

50. Here, it appears that no state law would prohibit the contemplated transfer of Customer PII. Upon reviewing various statutory privacy laws regarding the transfer of personal information, the statutory laws in this area seem to coincide with one another. For example, the North Dakota legislature, where Vanity Shops headquarters was located, has enacted Article 45-14, North Dakota Administrative

Code that codifies the procedure for transferring private consumer financial and health information. The conditions set forth in Article 45-14 will be met pursuant to this sale according to discussion with Vanity Shops and Vanity Brands.

D. Consumer Privacy Ombudsman Reports to Date

51. It appears that there have been at several dozen prior cases where a consumer privacy ombudsman has been appointed and filed a report, including: (i) *In re Refco, Inc., et al.*, Case No. 05-60006 (RDD) (Bankr. S.D.N.Y. 2005); (ii) *In re Three A's Holdings, LLC, et al.*, Case No. 06-10886 (BLS) (Bankr. D. Del. 2006); (iii) *In re Engaging and Empowering Citizenship, Inc.*, Case No. 02-BKC-28175-CGC (Bankr. D. Ariz. 2006); (iv) *In re Storehouse, Inc.*, Case No. 06-11144-SSM-Bankr. (E.D.Va. 2006); (v) *In re Western Medical, Inc.*, Case No. 06-01784 (Bankr. D. Ariz. Dec. 15, 2006); (vi) *Upland Surgical Institute*, Case No. 06-11298 (Bankr. C.D. Cal. June 20, 2006); (vii) *In re Foxton*, Case No. 07-24496 (Bankr. D.N.J. 2007); (viii) *In re Tweeter Home Entertainment Group, Inc. et al.*, Case No. 07-10787(PJW) (Bankr. D. Del. 2007); (ix) *In re R.J. Gators*, Case No. 07-14954 (Bankr. S.D. Fla. June 26, 2007); (x) *In re Old Carco LLC f/k/a Chrysler, LLC, et al.*, Case No. 09-50002 (AJG) (Bankr. S.D.N.Y. May 27, 2009); (xi) *In re Motors Liquidation Company f/k/a General Motors Corporation, et al.*, Case No. 09-50026 (REG) (Bankr. S.D.N.Y. July 1, 2009); and (xii) *In re Saint Vincent's Catholic Medical Centers of New York, et al.*, Case No. 10-11963 (CGM) (Bankr. S.D.N.Y. July 12, 2010); *In re North General Hospital*, Case No. 10-13553 (SCC)(Bankr. S.D.N.Y. 2010); *In re: Dots, LLC*, Case No. 14-11016 (DHS)(Bankr. D.N.J. 2014); *In re RadioShack Corporation*, Case No. 15-10197 (BLS)(Bankr. D. Del. 2015).

52. In general, these prior ombudsmen encountered similar sets of facts – debtors seeking to sell PII in the face of privacy policies that do not explicitly allow such transfers. In broad terms, each of these ombudsmen have supported the proposed sales, provided certain conditions were met, such as requiring that (i) the sales be made to qualified purchasers (those in the same business or that would operate the same business as the debtor); (ii) the purchaser would serve as a successor-in-interest to the debtor's security and privacy policies; (iii) customers be provided an opportunity to opt-in or

opt-out of the proposed transfer; and (iv) in limited cases, the information of children be purged.

VII. Section 332 Factors to be Considered

53. Section 332 of the Bankruptcy Code suggests at least four factors as to which a consumer privacy ombudsman may inform the Court in connection with the proposed sale of PII: (a) a debtor's privacy policy; (b) potential losses or gains of privacy to consumers if a sale is approved; (c) the potential costs or benefits to consumers if such sale is approved; and (d) potential alternatives that would mitigate potential privacy losses or potential costs to consumers.

54. **Debtor's Privacy Policies.** As discussed above, the Debtor's privacy policy are mixed. Debtor provides a privacy statement upon enrolling online and later provide a more elaborate privacy policy once enrolled. It is the Ombudsman's understanding that the more elaborate privacy policy was also used for in-store customers.

55. **The Potential Losses or Gains of Privacy to Consumers if Sale is Approved.** The Ombudsman believes that any potential privacy loss to consumers here will be minimal, if the transfer of custody of consumer records is made subject to the recommended conditions. For example, the transfer of PII to a Qualified Buyer is a common practice and will in this instance be subject to Vanity Shops' data privacy and security policies and procedures. In combination, these protections form, in effect, a backstop to ensure that required consumer privacy is maintained.

56. **The Potential Costs or Benefits to Consumers if Sale is Approved.** The Ombudsman believes that Debtor's proposed sale of Customer PII would greatly benefit consumers in this case. Once Vanity Brands' ecommerce platform is established, the transfer would permit Vanity Shops' customers to receive uninterrupted products and services from what will in effect be Vanity Shops. Any purchaser would require that data to effectively provide services. Thus, approving the proposed sale and the related transfer of PII would benefit consumers.

57. On the other hand, there does not appear to be any potential cost to consumers if the proposed PII is transferred, subject to the restrictions recommended in this Report.

58. **Potential Alternatives that Would Mitigate Potential Privacy Losses or Potential Costs to Consumers.** The best way to mitigate potential privacy losses is to impose requirements causing any potential purchaser to continue to meet consumers' privacy expectations. The general outline of those requirements has been provided in FTC guidance and cases, such as *Toysmart* and *Gateway Learning*, and in prior consumer ombudsman reports. The proposed requirements here with respect to Debtor's proposed PII transfers are set forth in the next section.

VIII. Findings and Recommendations

Findings

59. Based upon the foregoing, the Ombudsman makes the following findings:

- As part of its proposed sale, Vanity Shops seeks to transfer ownership of its Customer PII to a potential purchaser. That Customer PII is "Personally Identifiable Information" as that term is defined in Bankruptcy Code Section 101(41A).
- That proposed sale of Customer PII may be inconsistent with Vanity Shops' stated policies regarding such sales; therefore, Vanity Shops must show that the contemplated sale complies with the requirements of Bankruptcy Code Section 363(b)(1)(B). As a result, the proposed sale triggered the appointment of a consumer privacy ombudsman pursuant to Bankruptcy Code Section 332 and the submission of this Report.
- Vanity Shops gathered Customer PII primarily through its retail stores until its website was launched to allow enrollment online. Both the in-store and online enrollment appear to utilized the same privacy policy.
- Vanity Brands, LLC intends to acquire and operate the Vanity Shops' as an ongoing ecommerce platform and represents that it will continue to abide by or substantially meet the standards established by Vanity Shops' existing privacy policies.

- The Customer PII will be used to reach out to consumers and advise them of the purchase.

Recommendations

60. Accordingly, after review of the facts and circumstances of the proposed sale and transfer of records, the Ombudsman respectfully recommends that the Court may approve the sale and transfer of the Customer PII subject to the following conditions:

- Customer PII may be sold and transferred, provided that Vanity Shops demonstrates that such sale and transfer is to a “Qualified Buyer.” A “Qualified Buyer” means an entity that: (a) agrees to operate Vanity Shops’ rewards program as a going concern, (b) expressly agrees to be bound by and succeed by substantially similar terms as contained in Vanity Shops’ existing privacy policies; and (c) agrees to be responsible for any violation of existing privacy policies;
- The Qualified Buyer must agree to be bound by and substantially meet the standards established by Vanity Shops’ privacy policies, to maintain substantially the same level of information security currently maintained by Vanity Shops and comply with applicable privacy laws and regulations governing the transfer, storage, maintenance, and access to Customer PII;
- Vanity Shops and the Qualified Buyer agree to provide notice to any consumer whose Customer PII is being sold and transferred. That notice may be provided by a posting on Vanity Shops’ website or in any initial contact email or communication;
- Vanity Shops and the Qualified Buyer agree to provide consumers with an opportunity to opt-out as part of the notification process, to the extent required by law; and
- The Qualified Buyer shall file a certification within 30 days confirming their compliance with the conditions the Court may impose, or the Court may direct the Ombudsman to file a final report confirming such compliance.

61. If for any reason the Customer PII is sold to any other entity that would not meet the requirements of “Qualified Buyer,” then the Court should require that:

- The purchaser must, at a minimum, agree to abide by or substantially meet the standards of Vanity Shops’ existing privacy policies;

- Vanity Shops and the purchaser must provide notice to any consumer whose PII it holds of the proposed transfer; and
- As part of the notification, Vanity Shops and such a purchaser must provide customers with the opportunity to opt-in to the transfer, or their information would not be transferred but instead would be destroyed.

62. These proposed conditions are consistent with applicable precedent in this area, including Federal Trade Commission rulings and prior Consumer Privacy Ombudsman recommendations in other bankruptcy cases.

IX. Conclusion

63. Subject to the foregoing restrictions, the Ombudsman would respectfully recommend that the Court may approve the referenced transfer of Customer PII.

Dated: November 7, 2017

Respectfully submitted,

By: /s/ Luis Salazar
LUIS SALAZAR

Consumer Privacy Ombudsman

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CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on this day, I electronically filed the foregoing document with the Clerk of the Court using CM/ECF. I certify that the foregoing document is being served this day on all parties identified on the Service List attached to the original hereof via transmission of Notices of Electronic Filing generated by CM/ECF.

/s/ Luis Salazar

Luis Salazar

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EXHIBIT “A”

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

FEDERAL TRADE COMMISSION,
600 Pennsylvania Ave., N.W., Washington, DC 20580, Plaintiff,

v.

TOYSMART.COM, LLC,
170 High Street, Waltham, MA, 02453, a Delaware corporation, and

TOYSMART.COM, INC.,
170 High Street, Waltham, MA, 02453, a Delaware corporation, Defendants.

CIVIL ACTION NO. 00-11341-RGS

STIPULATED CONSENT AGREEMENT AND FINAL ORDER

On July 10, 2000, plaintiff, the Federal Trade Commission ("Commission" or "FTC") commenced this action by filing its complaint against defendants Toysmart.com, LLC and Toysmart.com, Inc. (collectively, "Toysmart" or "Defendants"). The Complaint alleges that Toysmart engaged in deceptive acts or practices in violation of Section 5 of the Federal Trade Commission Act ("FTC Act"), 15 U.S.C. § 45(a), by disclosing, selling or offering for sale personal customer information, contrary to the terms of its privacy policy that personal information would never be disclosed to third parties. The Complaint seeks a permanent injunction and other equitable relief pursuant to Section 13(b) of the FTC Act, 15 U.S.C. § 53(b).

The Commission and the Defendants, by and through their counsel, have agreed to settlement of this action upon the following terms and conditions, without adjudication of any issues of fact or law.

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED as follows:

FINDINGS

1. This Court has jurisdiction over the subject matter of this case and has jurisdiction over Defendants. Venue in this district is proper.
2. The Commission has the authority under Section 13(b) of the FTC Act, 15 U.S.C. § 53(b), to seek the relief it has requested.
3. The Complaint states a claim upon which injunctive relief may be granted against the Defendants under Sections 5(a) and 13(b) of the FTC Act, 15 U.S.C. §§ 45(a) and 53(b).
4. Defendants' activities are in or affecting commerce, as defined in 15 U.S.C. § 44.
5. Defendants waive all rights to seek judicial review or otherwise challenge or contest the validity of this Order. Defendants also waive any claim that they may have held under the Equal Access to Justice Act, 28 U.S.C. § 2412, amended by Pub. L. 104-121, 110 Stat

847, 863-64 (1996), concerning prosecution of this action to the date of this Order.

6. This agreement is for settlement purposes only and does not constitute an admission by Defendants that the law has been violated as alleged in the Complaint or that the facts as alleged in the Complaint are true.

7. Entry of the Final Order is in the public interest.

DEFINITIONS

For purposes of this Order:

1. "Defendants" means Toysmart.com, LLC and Toysmart.com, Inc.
2. "Customer Information" means information of or relating to consumers collected by Toysmart, including, but not limited to, name, address, billing information, shopping preferences, order history, gift registry selections, family profile information, and information about consumers' children, such as name, gender, birthday, and toy interests.
3. "Third Party" shall mean any individual, firm, or organization other than a Qualified Buyer and its successors, except to the extent that disclosure of Customer Information to such an individual, firm, or organization is necessary to maintain the technical functioning of the Toysmart Web site or to fulfill a consumer's request. "Third Party" includes any affiliates of a Qualified Buyer.
4. "Qualified Buyer" shall mean an entity that (1) concentrates its business in the family commerce market, involving the areas of education, toys, learning, home and/or instruction, including commerce, content, product and services, and (2) expressly agrees to the obligations set forth in the Stipulation and Order Establishing Conditions on Sale of Customer Information, entered by the Honorable Carol J. Kenner, Bankruptcy Judge for the United States Bankruptcy Court for the District of Massachusetts, on July __, 2000, in *In re: Toysmart.com, LLC*, Case No. 00-13995-CJK (the "Bankruptcy Order"), attached hereto as Exhibit A.

I. PROHIBITION AGAINST MISREPRESENTATIONS

IT IS HEREBY ORDERED that Defendants and their officers, agents, servants, employees, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, whether acting directly or through any corporation, subsidiary, division, or other device, are hereby restrained and enjoined from violating Section 5(a) of the FTC Act, 15 U.S.C. § 45(a), by:

- A. Making, or assisting in making, directly or by implication, in connection with the collection of Customer Information, any false or misleading representation about whether such information will be shared with Third Parties; and
- B. Disclosing, selling or offering for sale to any Third Party, any Customer Information collected by Defendants, except as expressly provided in the Bankruptcy Order.

II. REQUIREMENT THAT DEFENDANTS DELETE PERSONAL CUSTOMER INFORMATION

IT IS FURTHER ORDERED that, absent approval by the Bankruptcy Court on or before July 31, 2001, of the sale of the Customer Information to a Qualified Buyer or of a reorganization plan, Defendants and their officers, agents, servants, and employees shall, on or before August 31, 2001, delete or destroy all Customer Information in their possession, custody or control, and provide written confirmation to the FTC, sworn to under penalty of perjury, that all such Customer Information has been deleted or destroyed.

III. REQUIREMENT THAT DEFENDANTS COMPLY WITH THE CHILDREN'S ONLINE PRIVACY PROTECTION ACT

IT IS HEREBY ORDERED that Defendants and their officers, agents, servants, employees, and those persons in active concert or participation with them who receive actual notice of this Order by personal service or otherwise, whether acting directly or through any corporation, subsidiary, division, or other device, are hereby restrained and enjoined from violating the Children's Online Privacy Protection Act of 1998, 15 U.S.C. §§ 6501 *et seq.* and its implementing regulations, and are hereby required to delete or destroy any and all information collected in violation of 16 C.F.R. Part 312 *et seq.* within ten (10) days of the entry of this Order.

IV. FTC'S RIGHT TO FILE ACTION

IT IS FURTHER ORDERED that the Commission's agreement to and the Court's approval of this Order is expressly premised upon the truthfulness, accuracy, and completeness of the declaration sworn to under penalty of perjury provided by Toysmart and attached hereto as Exhibit B, stating that after diligent investigation it is not aware of any disclosures of customer information to third parties or other material violations of the Toysmart Privacy Statement prior to May 22, 2000, as the Commission relied upon this material information in negotiating and agreeing to the terms of this Order.

IT IS FURTHER ORDERED that nothing shall preclude the Commission from filing an action against Toysmart in this Court within the next one (1) year from the date of this Order, should the Commission subsequently obtain evidence that Toysmart in the above-referenced declaration failed to disclose a material violation of the Toysmart Privacy Statement, or made any other material misrepresentation or omission.

V. DOCUMENT RETENTION

IT IS FURTHER ORDERED that Defendants shall maintain for at least one (1) year from the date of service of this Order and, upon written request by FTC employees, make available to the FTC for inspection and copying:

- A. All records and documents necessary to demonstrate fully their compliance with each provision of this Order;
- B. A sample copy of any advertising and promotional material, including e-mail, regarding the sale of Defendants' tangible and intangible assets, other than the sale

of such assets in the bankruptcy case; and

C. Copies of any complaints received by Defendants regarding Defendants' alleged disclosure, sale or offering for sale of personal customer information.

VI. NOTICE TO RELATED PERSONS AND ENTITIES

IT IS FURTHER ORDERED that, for a period of one (1) year from the date of entry of this Order, Defendants shall:

A. Deliver a copy of this Order to all of Defendants' current and future principals, officers, directors, and managers, and to all of Defendants' current and future employees, agents, and representatives having responsibilities with respect to the subject matter of this Order, and shall secure from each such person a signed and dated statement acknowledging receipt of the Order. Defendants shall deliver this Order to their current personnel within thirty (30) days after the date of service of this Order, and to their future personnel within thirty (30) days after the person assumes such position or responsibilities; and

B. Maintain for a period of one (1) year after creation, and upon reasonable notice, make available to representatives of the Commission, the original signed and dated acknowledgments of the receipt of copies of the Order.

VII. COMPLIANCE REPORTING AND MONITORING

IT IS FURTHER ORDERED that, in order that compliance with the provisions of this Order may be monitored:

A. Sixty (60) days after the date of entry of this Order, Defendants shall provide a written report to the FTC, sworn to under penalty of perjury, setting forth in detail the manner and form in which they have complied and are complying with this Order;

B. For the purposes of this Order, Defendants shall, unless otherwise directed by the Commission's authorized representatives, mail all written notifications to the Commission to:

Associate Director, Division of Financial Practices
Federal Trade Commission
600 Pennsylvania Ave., N.W.
Washington, D.C. 20580
Re: FTC v. Toysmart.com

C. The Commission is authorized, without further leave of Court, for a period of one (1) year from the date of entry of this Order, to obtain discovery from any person in the manner provided by Chapter V of the Federal Rules of Civil Procedure, Fed. R. Civ. P. 26-37, including the use of compulsory process pursuant to Fed. R. Civ. P. 45, for the purpose of monitoring and investigating Defendants' compliance with any provision of this Order;

D. The Commission is authorized to use representatives posing as consumers and

suppliers to Defendants, Defendants' employees, or any other entity managed or controlled in whole or in part by defendants, without the necessity of identification or prior notice;

E. Nothing in this Order shall limit the Commission's lawful use of compulsory process, pursuant to Sections 9 and 20 of the FTC Act, 15 U.S.C. §§ 49 and 57b-1, to investigate whether defendants have violated any provision of this Order or Section 5 of the FTC Act, 15 U.S.C. § 45;

F. For a period of one (1) year from the date of entry of this Order, for the purpose of further determining compliance with this Order, Defendants shall permit representatives of the Commission, within three (3) business days of receipt of written notice from the Commission, access during normal business hours to any office or facility within the Defendants' custody, possession, or control storing documents and to permit inspection and copying of all documents within the Defendants' custody, possession or control relevant to any matter contained in this Order.

VIII. RETENTION OF JURISDICTION

IT IS FURTHER ORDERED that the Court retains jurisdiction of this matter for all purposes, including the construction, modification, and enforcement of this Order.

STIPULATED AND AGREED TO BY:

FOR THE PLAINTIFF:

Dated: _____, 2000

LAURA MAZZARELLA
ELLEN FINN
Federal Trade Commission
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580
(202) 326-2646

Attorneys for Plaintiff

FOR DEFENDANT TOYSMART.COM, LLC:

Dated: _____, 2000

HAROLD B. MURPHY
ALEX M. RODOLAKIS
Hanify & King
Professional Corporation
One Federal Street
Boston, MA 02110
(617) 423-0400

Attorneys for Defendant

Dated: _____, 2000

DAVID N. LORD
Chief Executive Officer, Toysmart.com, LLC

FOR DEFENDANT TOYSMART.COM, INC.:

Dated: _____, 2000

DAVID N. LORD
Chief Executive Officer, Toysmart.com, Inc.

IT IS SO ORDERED.

Dated: _____, 2000

Honorable Richard G. Stearns
UNITED STATES DISTRICT JUDGE

EXHIBIT “B”



Jessica L. Rich
Office of the Director
Bureau of Consumer Protection

UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

May 16, 2015

Elise Frejka, Esq.
Frejka PLLC
733 Third Avenue
New York, NY 10017

In Re: *RadioShack Corporation, et al.*, No. 15-10197 (BLS) (Bankr. D. Del.).

Dear Ms. Frejka:

For decades, the Federal Trade Commission (“FTC”) has acted to protect consumer privacy. Among other laws, the FTC enforces Section 5 of the Federal Trade Commission Act (“FTC Act”), which prohibits unfair or deceptive acts or practices. I am the Director of the FTC’s Bureau of Consumer Protection (“BCP”) and am writing to express BCP’s concerns¹ about the possible sale of certain consumer personal information currently in the possession of RadioShack Corporation (“RadioShack”) as part of the bankruptcy proceeding.² It is our understanding that this information is subject to a sale hearing before the Honorable Bankruptcy Judge Brendan L. Shannon on May 20, 2015. As the court-appointed Consumer Privacy Ombudsman, we request that you consider these comments when drafting your report and that you attach this letter to your report when you submit it to the court.

RadioShack and Its Privacy Policies

The facts as we understand them are as follows: RadioShack sold consumer electronics, including mobile devices, and other merchandise through brick-and-mortar stores and online. In the course of conducting its business, RadioShack collected personal information from millions of consumers, including name, physical mailing address (billing and shipping), telephone number, email address, credit or debit card number,³ and purchase history⁴ for over 117 million

¹ Please note that the views expressed herein do not necessarily reflect the views of the Federal Trade Commission or any individual Commissioner.

² *In re RadioShack Corporation, et al.*, No. 15-10197 (BLS) (Bankr. D. Del.). For purposes of this letter, RadioShack is defined to include RadioShack Corporation and its seventeen affiliated debtors in their jointly administered Chapter 11 bankruptcy cases.

³ RadioShack has represented that credit and debit card information in its possession was modified through marking or hashing after 120 days, thereby making it unreadable.

customers. RadioShack states that its current database contains consumer information collected over many years and that the overall accuracy of the data is uncertain, as many of the data entries may be duplicates or not current.

RadioShack collected this information from consumers under one of at least two different privacy policies it has disclosed during bankruptcy proceedings. The first, published on the www.radioshack.com website at the petition date of the bankruptcy filing, states in relevant part:

Personally identifiable information

Personally identifiable information may include information that you provide to us by requesting information, when registering for special offers or programs or when you purchase products online. This may include your name, address (including billing and shipping addresses), telephone number, e-mail address, organization, city, state and zip code. We may use this information, to process and ship orders, to contact you about the status of your order, to contact you with answers to your questions, or to provide information about new and exciting products, services, promotions and corporate-related information. We may use mailings, telephone calls and e-mail to contact you.

Information sharing and disclosure

Agents, employees and contractors of RadioShack who have access to personally identifiable information are required to protect this information in a manner that is consistent with this Privacy Policy and the high standards of the corporation.

- Information about you specifically will not be used for any purpose other than to carry out the services you requested from RadioShack and its affiliates. All of our affiliates have agreed to maintain the security and confidentiality of the information we provide to them.
- **We will not sell or rent your personally identifiable information to anyone at any time.**⁵
- We will not use any personal information beyond what is necessary to assist us in delivering to you the services you have requested.
- We may send personally identifiable information about you to other organizations when:
 - We have your consent to share the information (you will be provided the opportunity to opt-out if you desire). For example, if you opt-in for emails we will share this information with our marketing provider.

⁴ RadioShack has represented that purchase history was retained for a period of three years unless the consumer obtained a service plan or warranty, in which case the purchase history was retained indefinitely. During the last five years, however, RadioShack has retained all purchase history to comply with litigation holds.

⁵ This statement has appeared on a version of the radioshack.com privacy policy since at least April 2004.

- We need to share your information in order to provide the product or service you have requested. For example, we need to share information with credit card providers and shippers to bill and ship the product you requested.
- We are required to do so by law, for example, in response to a court order or subpoena.

(Emphasis added).⁶

Another RadioShack privacy policy, displayed to consumers on various signage in RadioShack stores, contained similar language restricting the sale of personal information:

We Respect Your Privacy

We Do Not Sell Our Mailing List

The information you give us is treated with discretion and respect. **We pride ourselves on not selling our private mailing list.** From time to time, we may send you information from our company or from select, responsible companies that may join with RadioShack to bring you special offers.

If you no longer wish to receive offers and information, please call us at 1-800-843-7422 or visit us at www.RadioShack.com. (Emphasis added).⁷

For the period covered by these privacy policies, RadioShack thus clearly and expressly represented that customer information would not be rented or sold to third parties.

The representations RadioShack made to its customers about the privacy of their information, including name, address, telephone number, email address, and purchase history, would likely be considered very important to many customers. We understand that the purchase history for sale from the RadioShack database includes 21 categories of information.⁸

⁶ RadioShack Online Privacy Policy, 2014, *available at* <http://www.radioshack.com/privacy-policy/privacy.html>.

⁷ See STATE OF TEXAS'S LIMITED OBJECTION TO SALE OF PERSONALLY IDENTIFIABLE INFORMATION OF ONE HUNDRED SEVENTEEN MILLION CONSUMERS, ECF Dkt. No. 1393, Exh. C.

⁸ The Commission has acted in previous instances to address privacy issues presented by the sale or disclosure of purchase history information that is sensitive. See *FTC v. Toysmart*, No. 00-11341-RGS (D. Mass. 2000), *available at* <https://www.ftc.gov/enforcement/cases-proceedings/x000075/toysmartcom-llc-toysmartcom-inc> (consent order relating to sale in bankruptcy of children's information, including shopping preferences); *In the Matter of MTS, Inc., d/b/a Tower Records/Books/Video*, No. C-4110 (F.T.C. 2004) (consent order settling charges that Tower Records misrepresented the privacy, confidentiality, and security of consumers' personal information, including past purchase histories, on its website); Letter from Maneesha Mithal, Associate Director, Division of Privacy and Identity Protection to Reed Freeman (Mar. 12, 2010), *available at* <http://www.ftc.gov/os/closings/100312netflixletter.pdf> (letter to counsel for Netflix, Inc. closing staff investigation regarding concern that release of movie viewing datasets could be re-identified and expose customer identity and film viewing histories and preferences); and Letter from David C. Vladeck, Director, Bureau of Consumer Protection to Jane Horvath, Google, Inc. (Sept. 2, 2009), *available at* <http://www.ftc.gov/os/closings/090903horvathletter.pdf> (expressing concern regarding potential online behavioral

Consumers who provided their personal information to RadioShack would likely be very concerned if it were to be transferred without restriction to an unknown purchaser for unknown uses.

Potential Sale or Transfer of Personal Information

We understand that RadioShack's customer information constitutes a potentially valuable asset. We are concerned, however, that a sale or transfer of the personal information of RadioShack's customers would contravene RadioShack's express promise not to sell or rent such information and could constitute a deceptive or unfair practice under Section 5 of the FTC Act.⁹

The Commission has brought many cases alleging that the failure to adhere to promises about information privacy constitute a deceptive practice under the FTC Act.¹⁰ These cases include *FTC v. Toysmart*,¹¹ in which the Commission sued an online toy retailer which had filed for bankruptcy and sought to auction the personal information it collected from its customers. The Commission alleged that the sale of personal information constituted a deceptive practice because the company had represented in its privacy policy that such information would never be shared with third parties.¹²

We have similar concerns about the potential deceptive nature of the transfer of customer information in this case. We recognize, however, that bankruptcy presents special

advertising or secondary use of consumer search, purchase, and reading history associated with Google Books project).

⁹ 15 U.S.C. § 45.

¹⁰ See, e.g., *In the Matter of Snapchat, Inc.*, No. C-4501 (F.T.C. 2014) (consent order), available at <http://www.ftc.gov/enforcement/cases-proceedings/132-3078/snapchat-inc-matter>; *Facebook, Inc.*, No. C-4365 (F.T.C. 2012) (consent order), available at <http://www.ftc.gov/os/caselist/0923184/index.shtm>; *FTC v. ControlScan, Inc.*, No. 1:10-cv-00532-JEC (N.D. Ga. 2010) (Stipulated Final Judgment and Order for Permanent Injunction and Other Equitable Relief), available at <http://www.ftc.gov/os/caselist/0723165/index.shtm>; *In the Matter of Google, Inc.*, No. C-4336 (F.T.C. 2011) (consent order), available at <http://www.ftc.gov/os/caselist/1023136/index.shtm>; *In the Matter of Chitika, Inc.*, No. C-4324 (F.T.C. 2011) (consent order), available at <http://www.ftc.gov/os/caselist/1023087/110617chitikacmpt.pdf>.

¹¹ First Amended Complaint for Permanent Injunction and Other Equitable Relief, No. 00-11341-RGS (D. Mass. July 21, 2000), available at <http://www.ftc.gov/os/2000/07/toysmartcomplaint.htm>.

¹² *Id.* Since the *Toysmart* case, the Bureau has sent letters similar to this one, advocating on behalf of consumers whose personal information was subject to potential transfer or sale in bankruptcy proceedings. See Letter from Jessica L. Rich, Director, FTC's Bureau of Consumer Protection to The Honorable Shelley C. Chapman, United States Bankruptcy Judge, Bankruptcy Court for the Southern District of New York. (May 23, 2014), available at <https://www.ftc.gov/public-statements/2014/05/commission-letter-jessica-l-rich-director-bureau-consumer-protection-filed> (letter to bankruptcy court judge expressing concern that potential sale of student personal information may violate Bankruptcy Code and Section 5 of the FTC Act); Letter from David C. Vladeck, Director, FTC's Bureau of Consumer Protection to Michael St. Patrick Baxter, Esq., et al. (Sept. 14, 2011), available at http://www.ftc.gov/sites/default/files/documents/public_statements/protection-personal-customer-information-held-borders-group/110914bordersletter.pdf (letter to bankruptcy court-appointed Consumer Privacy Ombudsman noting potential Section 5 concerns associated with selling personal information in a manner inconsistent with privacy policy representations); Letter from David C. Vladeck, Director, FTC's Bureau of Consumer Protection to Peter Larson, et al. (July 1, 2010), available at <http://www.ftc.gov/os/closings/100712xy.pdf> (setting forth concerns about the transfer of personal information about subscribers to gay male youth-oriented XY Magazine to a new owner of the business).

circumstances, including the interest in allowing a company to get back on its feet – or alternatively, to marshal remaining assets for its creditors – consistent with any promises made to customers. *Toysmart* is instructive on this point. There, the Commission entered into a settlement with the company allowing the transfer of customer information under certain limited circumstances: 1) the buyer had to agree not to sell customer information as a standalone asset, but instead to sell it as part of a larger group of assets, including trademarks and online content; 2) the buyer had to be an entity that concentrated its business in the family commerce market, involving the areas of education, toys, learning, home and/or instruction (*i.e.*, the same line of business that Toysmart had been in); 3) the buyer had to agree to treat the personal information in accordance with the terms of Toysmart’s privacy policy; and 4) the buyer had to agree to seek affirmative consent before making any changes to the policy that affected information gathered under the Toysmart policy. These conditions served to protect consumer interests by ensuring that the data would be used consistent with Toysmart’s promises by an entity that was essentially operating as a new owner of the business, as opposed to a “third party” who was merely the highest bidder in a winner-take-all auction that may not have a reputational interest in handling the information in the same manner.

We believe the *Toysmart* precedent is an appropriate model to apply here to third parties. In this case, consumers provided personal information to RadioShack with the expectation that RadioShack might use it, for example, to make new offers of interest to consumers, but not to sell or rent it. As in *Toysmart*, our concerns about the transfer of customer information inconsistent with privacy promises would be greatly diminished if the following conditions were met:

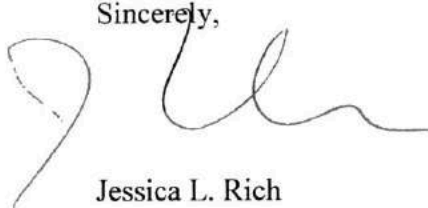
- The customer information is not sold as a standalone asset;
- The buyer is engaged in substantially the same lines of business as RadioShack;
- The buyer expressly agrees to be bound by and adhere to the terms of RadioShack’s privacy policies as to the personal information acquired from RadioShack; 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.

As an alternative, we believe it would be appropriate for RadioShack to obtain affirmative consent from its customers before it transfers the data. The consent process would allow customers to make their own determination as to whether a transfer of their information would be acceptable to them. For consumers who do not consent, their data would be purged.

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Thank you for this opportunity to express our concerns. We appreciate your consideration of these comments. If you have any additional questions about this matter, please contact Jamie Hine at (202) 326-2188 or jhine@ftc.gov.

Sincerely,

A handwritten signature in black ink, appearing to read "JL Rich", written over the word "Sincerely,".

Jessica L. Rich