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Transferring Customer Data in an Asset Sale

Be careful what you've promised your customers … or what has been promised about data you buy!

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In today's world, consumer data is a huge asset for companies across all industries, in particular those in technology-focused spaces like social media, apps, wearables and e-commerce. The value of such data, however, is at least partly dependent on the extent to which the data can be transferred to third parties without restrictions on use. The ability of a company to sell or otherwise transfer its consumer data, whether in a merger, acquisition or otherwise, typically ties back directly to statements made in the company's privacy policy. As illustrated by RadioShack's recent bankruptcy sale, the latest in a series of high-profile examples over the years on this topic, promising not to share consumer information can create a significant obstacle for future asset sale transactions.

The RadioShack Bankruptcy

RadioShack Corporation filed for Chapter 11 bankruptcy on February 5, 2015. Following an auction in May that was won by hedge fund Standard General LP (through its affiliate General Wireless Operations Inc.), RadioShack agreed to sell to General Wireless for $26.2 million RadioShack's brand name and various other assets, not the least of which included its customer data. RadioShack had proposed to sell approximately 117 million customer records which included first and last names, mailing addresses, email addresses, phone numbers, and other personally identifiable information of its customers.

That's when the Federal Trade Commission (FTC) and a coalition of over 30 state Attorneys General led by Texas stepped in. What were the FTC and state AGs so concerned about? The answer is actually quite simple: RadioShack was seeking to sell personal information about its customers to a third party, but RadioShack had promised in its privacy policies that it would *not* sell such information to any third party.

Promises in RadioShack's Privacy Policies

Specifically, RadioShack's online privacy policy in effect as of the bankruptcy petition date included the following statements seized upon by the FTC and state AGs:

- "We will not sell or rent your personally identifiable information to anyone at any time."
- "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 use any personal information beyond what is necessary to assist us in delivering to you the services you have requested."

And RadioShack's various privacy policies posted on in-store signage contained similar language called out by the FTC and state AGs, such as:

- "At RadioShack, 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."

The Resulting Sale as Approved Severely Limited the Data Transferred

On June 4, 2015, the deal was approved by the U.S. Bankruptcy Court for the District of Delaware, but only after the customer data that RadioShack originally proposed to sell—and that General Wireless originally sought to buy—was significantly pared back, to accommodate the consumer privacy-related objections raised by the FTC and the state AGs.

In a mediated compromise triggered by the regulatory objections, RadioShack agreed to destroy the overwhelming bulk of its customer data, and instead to transfer to General Wireless only: (i) the email addresses of RadioShack's customers who were "active" within the two-year period prior to the date of the bankruptcy petition and who did not exercise an opt-out that the bankruptcy court required General Wireless to implement, along with (ii) a limited set of "transaction data" from the five-year period prior to the petition date (e.g., store number, ticket date/time, and SKU number).[1]

Key Takeaways

As RadioShack's experience demonstrates, selling or otherwise transferring customer data to a third party can trigger thorny regulatory and consumer protection issues if the selling company's privacy policy contains any language indicating that such data will not be sold or transferred. In a line of authority going back over fifteen years, the FTC has consistently pronounced that such a transaction, even through a bankruptcy, could constitute a deceptive practice under applicable consumer protection laws.

Nevertheless, for many companies, an M&A transaction or other deal in which customer data are sold or shared is a very real possibility, often a primary objective for technology startups. The RadioShack case serves as an important reminder for such companies to confirm that their privacy policies provide the necessary flexibility to allow them to transfer their customer data to third parties—in particular, without triggering questions from regulatory authorities, customers, investors or potential buyers about whether the

[1] Indeed, although the reasoning behind the mediated outcome was not stated, RadioShack may only have been allowed by the bankruptcy court to transfer even these limited sets of customer data due to the special circumstances present in the bankruptcy context—that is, the interest in allowing the bankrupt company to get back on its feet or to marshal remaining assets for its creditors.

transfer is authorized under the terms of the applicable privacy policy. Legal counsel should always be consulted, but at the very least this would mean staying away from statements along the lines of those that tripped up the RadioShack transaction, and including an appropriate carve out for mergers and acquisitions and similar transactions.[2]

And on the other side of the fence, the experience of General Wireless—an acquiring company receiving a far smaller amount of the target company's customer information than originally sought—also serves as an important reminder for acquiring parties that some customer data on the selling block may come with strings attached, and in certain cases could even be forced to be left behind.

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[2] Note that making any change to an existing privacy policy intended to be applied to information collected prior to the policy change is generally considered to be "material," and to be effective FTC precedent dictates that affirmative express consent must be obtained from all affected customers or users—for example, through a direct email exchange or in connection with the user's next transaction. Also, the FTC advises companies to be clear and upfront when soliciting such consent, rather than making it seem as though consumer privacy is being extended in some way.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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