

The Impact Of Privacy On FDIC Resolution Plans

Law360, New York (November 17, 2011, 1:00 PM ET) -- On Sept. 13, 2011, the Federal Deposit Insurance Corporation adopted an interim final rule (the "FDIC rule") that requires insured depository institutions with \$50 billion or more in total assets (a covered insured depository institution or "CIDI") to prepare and submit periodic resolution plans.[1]

The goal of the FDIC rule is to permit the FDIC, as bankruptcy receiver, to maximize the net present value return from the sale or disposition of a CIDI's assets, and ensure that depositors quickly receive access to deposits and minimize losses to creditors.

The FDIC rule's asset maximization goal, however, may conflict with existing requirements for CIDs and other financial institutions to keep safe and confidential their customers' personally identifiable information ("PII"). CIDs and their counsel will be well advised to consider customer privacy issues before drafting and submitting their resolution plans.

PII is becoming a key asset class for many businesses that deal directly with consumers. Indeed, the Bankruptcy Code recognizes PII as an identifiable asset class that can be sold and transferred by a debtor, as long as such disclosure or sale complies with a company's privacy policy and consumers are warned that such a sale may occur.

The 2005 amendments to the Bankruptcy Code added new Sections 363(b)(1) and 332 to the Bankruptcy Code, which apply: "If the 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." [2]

In such a situation, a bankruptcy trustee "may not sell or lease personally identifiable information to any person" unless such a sale or such lease is consistent with the company's privacy policy, or after appointment of a consumer privacy ombudsman in accordance with Section 332, and after notice and a hearing, the court approves such sale or such lease.

The Bankruptcy Code's relevant definition of PII is broad and includes details such as an individual's name, postal and email address, telephone number, Social Security number and payment card number that an individual provides to a debtor "in connection with obtaining a product or service from the debtor primarily for personal, family, or household purposes."^[3]

Prior to the enactment of the 2005 amendments, bankruptcy courts did not view as a significant issue the protection of consumer privacy in connection with asset sales that involved personal information. In 2000, however, the Federal Trade Commission sought to raise the public's awareness of privacy implications of bankruptcy asset sales in the case of *In re Toysmart.com LLC*.^[4]

Toysmart.com LLC sought the bankruptcy court's approval to sell certain assets, including the company's customer lists, through a public auction. Toysmart's applicable privacy notice stated that the company's customers could "rest assured" that their information would "never be shared with a third party." Upon learning of the proposed sale of customer lists, the FTC filed an action in federal court seeking to enjoin the sale.

The FTC alleged that the sale was inconsistent with the promises Toysmart made in its privacy notice and, therefore, a deceptive trade practice that violated §5 of the FTC Act.^[5] While Toysmart subsequently reached a settlement with the FTC to allow the sale, the attorneys general of 47 states objected to the settlement, which had not yet been approved by the bankruptcy court.

Faced with such opposition, Toysmart withdrew the customer lists from the auction and eventually destroyed the information. To prevent similar sales of personal information in bankruptcy, Congress included protections against the sales of PII as part of the 2005 Bankruptcy Code Amendments.

Since the 2005 amendments, the disposition of PII has delayed the orderly dissolution of several companies that have collected that information from customers, and who have looked to sell it after encountering financial difficulties. A consumer privacy ombudsman has been appointed in many cases, including bankruptcy proceedings involving General Motors Co., Circuit City, Refco, The Sharper Image, Tweeter Home Entertainment Group Inc.

In these cases, the ombudsmen have seen their role as advising the court on an acceptable disposition of the debtor's customer list. Typically, the ombudsman reviews the applicable privacy policy, considers what personally identifiable information is possessed by the debtor, evaluates the possible effects of a proposed sale on privacy expectations and may suggest factors that could influence whether the court may allow a transfer of at least some of the personally identifying information. It is an expensive and time-consuming process that may ultimately reduce the value of the company's PII.

In contrast, when a proposed bankruptcy sale or lease of PII is consistent with a debtor's public position, bankruptcy courts have allowed the sale without appointing a consumer privacy ombudsman. For example, in *In re Boscov's Inc.*, the debtor, Boscov's Inc., owned and operated a full-service department store chain.^[6] Boscov's collected PII on the company's website and by other means in connection with order forms, customer service inquiries, credit card applications and other submissions.

Boscov's sought to sell substantially all of its assets, including the PII of its customers, in its chapter 11 proceeding. The relevant privacy notice provided that "[i]n the event that some or all of the business assets of Boscov's are sold or transferred, [Boscov's] may transfer the corresponding information about our customers." In light of the language contained in Boscov's privacy notice, the bankruptcy court approved the sale without appointing a consumer privacy ombudsman or imposing other restrictions on the personal information.

Unlike companies in other industries, financial companies have their own sector-specific laws that require the posting of a privacy notice and impose substantive restrictions on the sharing of certain personal information. Under the Gramm-Leach-Bliley Act ("GLB Act"),^[7] financial institutions are required to adopt privacy policies to protect PII, which is defined to include information: (1) provided by a consumer to a financial institution; (2) resulting from any transaction with the consumer or any service performed for the consumer; or (3) otherwise obtained by the financial institution. Financial institutions must also provide notice of their privacy policies and practices regarding the disclosure of PII to both affiliated and non-affiliated third parties, and provide an "opt-out," directing the institution not to share PII.

The GLB Act contains several exceptions to the notice requirement, including if PII is shared with a third party "in connection with a proposed or actual sale, merger, transfer, or exchange of all or a portion of a business or operating unit if the disclosure of nonpublic personal information concerns solely consumers of such business or unit." 15 U.S.C. § 6802(e)(7). Unlike the broad privacy policy in Boscov's, however, the GLB Act's (e)(7) exception is specific. It applies to the sale or transfer of an entire business or operating unit, and only with respect to the PII of consumers of that specific business or unit.

The (e)(7) exception does not address situations where a company seeks to sell or transfer consumer PII across several business units, or by itself without an operating business. CIDI privacy policies should therefore include a provision for the sale or lease of PII, separate and apart from when entire business lines are sold together, to maximize their ability to be flexible with PII in the event of financial distress and/or bankruptcy.

What about with respect to the FDIC resolution plans?

The FDIC rule is not yet in effect, and it is too early to understand the full impact that the FDIC rule will have on the security of PII and the burden that companies will face to safeguard such information. A few observations, however, can be made:

- The FDIC rule requires CIDs to provide a strategy for the sale or disposition of core business lines and major assets in a way that "maximizes the net present value return from the sale or disposition of such assets." CIDs should craft that strategy with PII in mind, and try to structure the resolution plans in terms of the GLB Act (e)(7) exception, to best minimize the chance that a bankruptcy sale is held up.
- CIDs should review their privacy policies and ensure that they are consistent with the resolution plans they are developing. At a minimum, any inconsistency may affect how quickly and efficiently the CIDI is resolved in bankruptcy. At this stage, it is unclear what will occur if a resolution plan conflicts with the own consumer privacy policy, and whether the FDIC work with the company to amend its resolution plan, privacy policy or both.

- The rule requires that CIDs provide a “detailed inventory and description of the key management information systems and applications, including systems and applications for risk management.” This may include systems to safeguard privacy and data security.

Several questions remain, therefore, and may not be answered until CIDs begin to file initial resolution plans and the FDIC works with these companies to refine their plans. Other questions also exist. For example, once the FDIC approves a resolution plan, what effect will the plan have in bankruptcy and on the PII safeguards of § 332?

Further, what does the FDIC’s acceptance of a particular resolution plan mean with respect to consumer protection agencies like the FTC and state consumer protection agencies and the likelihood of bringing enforcement actions with respect to PII? Will the FDIC’s acceptance of a plan shield a CID from liability, even if its resolution plan treats PII differently than its privacy policy?

It would make sense for CIDs and their counsel to confront these issues, since the FDIC has indicated a willingness to speak to CIDs about their resolution plans and does not expect initial plans to be perfect. Tackling these issues in the absence of specific regulatory mandates may seem like an increased burden to companies. However, because of the GLB Act’s and the FTC Act’s strong PII protection mechanisms, and the willingness of bankruptcy courts to hold up the bankruptcy process to protect PII, thinking about these issues in advance may save CIDs significant time and expense down the line.

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[1] On the same date, the board of governors of the Federal Reserve System and the FDIC adopted a joint final rule to implement section 165(d)(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act regarding resolution plans for dismantling certain nonbank financial company supervised by the board and each bank holding company with total assets of \$50 billion. The FDIC interim rule and Dodd-Frank final rule are meant to be complementary.

[2] 11 U.S.C. § 363(b)(1).

[3] 11 U.S.C. § 101(41A).

[4] In re Toysmart.com LLC, Case No. 00-13995-CJK (Bankr. D. Mass. June 9, 2000).

[5] 15 U.S.C. § 45.

[6] In re Boscov’s Inc., et al., Case No. 08-11637 (Bankr. D. Del. Aug. 4, 2008).

[7] 15 U.S.C. § 6801-09.

