

3-2003

## **Muddy Property: Generating and Protecting Information Privacy Norms in Bankruptcy**

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# MUDDY PROPERTY: GENERATING AND PROTECTING INFORMATION PRIVACY NORMS IN BANKRUPTCY

EDWARD J. JANGER\*

## ABSTRACT

*Bankruptcy law does not deal well with website promises to protect personal information. The legal treatment of privacy policies in bankruptcy currently turns on whether such policies are viewed as creating contract rights or property rights. Neither characterization fits well, and any attempt to shoehorn information privacy into either category has significant costs. Contract obligations are subject to discharge in bankruptcy, and any consumer expectations of privacy (contractual or otherwise) are likely to be defeated. By contrast, if personal information is deemed property of the website customer, information transfers that might benefit consumers will be stifled. This Article develops an approach, based on "muddy property rights," that has the potential to strike an appropriate balance between these two extremes.*

*The property / contract distinction within bankruptcy law mirrors a broader discussion in the legal academy, begun by Calabresi and Melamed, about the proper domain of property and liability. The debate among privacy scholars about data privacy similarly tracks the Calabresian divide. Larry Lessig favors propertization*

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\* Associate Professor of Law, Brooklyn Law School. Thank you to Susan Block-Lieb, Dana Brakman-Reiser, Neil Cohen, Kevin Davis, Dan Keating, Claire Kelly, Roy Kreitner, Lynn LoPucki, Nancy Rapoport, Paul Schwartz, Dan Solove, Spencer Webber Waller, Steve Ware, Jay Weiser, Jay Westbrook, Jonathan Yovel, and participants in both the Arthur Moller Workshop at the University of Texas Law School, and the Brooklyn Law School Faculty Forum for comments on an earlier draft. Jessica Lubarsky provided talented research and editorial assistance. Special thanks also go to Dean Joan Wexler and the Dean's Research Fund at the Brooklyn Law School for generous financial support. Mistakes are, of course, mine alone.

*of personal information, while other privacy advocates, such as Marc Rotenberg and Jessica Litman, oppose Lessig's proposal because they believe commodifying personal information will ultimately be destructive rather than protective of privacy. All three misunderstand the effect of property on privacy: Lessig ex ante, and Rotenberg and Litman ex post. Lessig's focus on remedy (following both Calabresi and Coase) assumes that the content of the substantive right to information privacy is irrelevant, because an efficient allocation of rights will ultimately be reached, one way or another, by private negotiation. However, contractual negotiation is not always an efficient mechanism for allocating entitlements. Adhesion, information asymmetries, and coordination problems raise thorny issues where e-commerce transactions are concerned. In these transactions, one cannot rely on private negotiation or markets to generate the appropriate terms for data sharing. Rotenberg and Litman, by contrast, ignore the fact that without the status of "property," information privacy norms will go entirely unenforced in bankruptcy.*

*By focusing on remedy, the information privacy literature has failed to explore the interaction between substantive rights (which can be crystalline or muddy), and remedies (which can be based in property or liability). I argue that "muddy property rights" based on fair information practices point the way toward a more nuanced approach to the interaction between right and remedy. As I have discussed in earlier work, muddy rules serve a dual function: (1) they deter troubling transactions; and (2) they force contracting parties, ex ante, to recognize that they might have to justify their contractual terms ex post. In the information privacy context, however, muddy entitlements, and muddy property rights in particular, could serve a third purpose. They would force information into the legal system about norm-related behavior, and allow judges and the judiciary to enforce and articulate privacy norms through the incremental development of common law rules.*

*In short, if privacy norms for e-commerce transactions are to be enforced in bankruptcy, they need to be protected by property rights, and if they are to be generated by public dialogue and public processes, those property rights should be muddy.*

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*No statutory draftsman has a crystal ball in which he can read the future. The best he can do is make some kind of sense out of the recent past. A well-drafted statute will deal sensibly with the issues which have come into litigation during the twenty or twenty-five years which preceded the drafting. However, the focus of litigation has a way of shifting unexpectedly and unpredictably. New issues, which no one ever dreamed of, present themselves for decision. With luck, the statute will turn out to have nothing to say that is relevant to the new issues, which can then be decided on their own merits.<sup>1</sup>*

### INTRODUCTION

Imagine that it is February 2000. The dot-com boom is resonating through the economy. Yahoo Corporation (Yahoo), the owner of a website called "Yahoo.com,"<sup>2</sup> has just gone public. Yahoo.com is the brainchild of CEO and principal shareholder Max Headcold, and sells herbal and nutritional supplements over the World Wide Web. Yahoo's marketing focuses particularly on cold remedies. When customers visit the Yahoo.com website they are asked to provide certain information about their particular respiratory ailments, or, as the case may be, their personal fitness goals. Yahoo's proprietary software then uses this information to provide the customer with a tailored herbal regimen. These customers have value in two ways: as relationships (i.e., people who buy Yahoo's products), and as information (i.e., preferences of people who might be convinced to buy other people's products).

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1. GRANT GILMORE, *THE AGES OF AMERICAN LAW* 96 (1977).

2. Yahoo.com is a purely fictitious company that first made its appearance as a teaching hypo at the Second Annual Zaretsky Roundtable at the Brooklyn Law School on April 11, 2000. The Zaretsky Roundtable is an annual event where bankruptcy lawyers and professors gather to talk about bankruptcy and to honor the memory of Barry Zaretsky, an extraordinary bankruptcy scholar and teacher at the Brooklyn Law School from 1978 until his untimely death in 1997. For an updated version of the teaching materials for that program, see Neil Cohen, Michael Gerber, and Edward J. Janger, *Bankruptcy in a Brave e-World: Planning for the Day a Dot-com Crashes*, in *WORKOUTS & BANKRUPTCIES IN THE E-COMMERCE ECONOMY* 247 (Joseph Samet & John Walshe Murray eds., 2001) [hereinafter *E-COMMERCE*]. Yahoo's first fictitious attempt to sell private information actually predates Toysmart's by a few months.

Needless to say, this information would be valuable to other companies interested in marketing the latest form of high-tech tissue paper or ultrasonic vaporizer to Yahoo's customers. Yahoo, however, has posted a privacy policy on its website that states in no uncertain terms:

WE WILL NOT SHARE YOUR PERSONAL INFORMATION  
WITH THIRD PARTIES UNDER ANY CIRCUMSTANCES. WE  
MEAN IT! WE MEAN IT! WE MEAN IT!!!!

Yahoo made this promise because Headcold felt that many of Yahoo's customers would be more comfortable doing business with Yahoo if they believed that their information would be held in confidence. Headcold also felt that when the time came to sell high-tech tissue paper or ultrasonic vaporizers to their customers, Yahoo would simply branch out into those businesses.

Now, fast forward to March 2003. Yahoo has fallen upon hard times, and has decided to reorganize under Chapter 11 of the Bankruptcy Code. During the planning discussions, you (Yahoo's lawyer) and Headcold explore a number of options. The first plan is to obtain financing and seek to continue the business. The second plan is to liquidate the assets of the business, either in whole or in part, carving up the various pieces in order to obtain the most value. Headcold also recognizes that reorganizing may require Yahoo to sell off some of its assets to raise cash. In this connection, Headcold turns to you and asks two questions: (1) "Given our privacy policy, can we sell Yahoo's customers with their personal information?"; and (2) "Can we sell that information without the customers' permission?" Your initial attempt to answer these questions would begin and, under current law, end with the somewhat delphic, and widely reported, story of Toysmart.com—a cautionary tale that simultaneously left Toysmart unable to sell its customer data, *and* struck fear into the hearts of privacy advocates.

In the spring of 2000, an involuntary bankruptcy petition was filed against Toysmart.com.<sup>3</sup> Notwithstanding a published privacy policy under which it, like Yahoo, had promised not to sell personal customer information, Toysmart's liquidation consultants sought to

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3. *In re Toysmart.com, LLC*, No. 00-13995-CJK (Bankr. D. Mass. filed June 9, 2000).

sell the company's customer lists.<sup>4</sup> Public outcry and an FTC investigation stopped the Toysmart data sale in its tracks, and spawned a number of legislative proposals, including an amendment to the Bankruptcy Code introduced by Senator Patrick Leahy (Leahy Amendment), contained in sections 231 and 232 of the Conference Report<sup>5</sup> on the Bankruptcy Abuse Prevention and Consumer Protection Act of 2002 (Bankruptcy Reform Bill).<sup>6</sup> This Article seeks to show that both the Leahy Amendment and recent scholarly proposals, by Larry Lessig<sup>7</sup> and others, to protect data

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4. Stipulation and [Proposed] Order Establishing Conditions on Sale of Customer Information, presented by Toysmart.com, LLC and the Federal Trade Commission, *reprinted in* Samet & Murray, E-COMMERCE *supra* note 2, at 9 [hereinafter Toysmart Stipulation] (reproducing a stipulation and proposed order placing conditions on the sale of customer information by Toysmart.com).

5. H.R. CONF. REP. NO. 107-617, at 51-52 (2002) [hereinafter Conference Report]. The Leahy Amendment is reproduced in the Appendix of this Article.

6. H.R. 333, 107th Cong. (2002). While the House and Senate each passed slightly different versions of the Bankruptcy Reform Bill by veto-proof majorities, one delay after another prevented the bill's enactment. Ultimately, it died at the end of the 107th Congress. First it became the battleground over which the Senate leadership battled out the rules for power sharing in the deadlocked Senate. Agreement was reached, only to have Senator Jeffords switch party affiliations and again reshape the balance of power in the Senate. The Conference Committee was finally named and held its first meeting, only to be delayed indefinitely by the events of September 11, 2001. *See* Riva D. Atlas, *Democrats Review Changes in Bankruptcy*, N.Y. TIMES, Jan. 24, 2002, at C8. In November 2001, the Conference Committee met again to discuss the bill, but by that time, the country had slipped into recession, and enthusiasm for a bill that, by all accounts, restricts the availability of bankruptcy relief to individual consumer debtors appeared to wane. *Id.* The Conference Committee again met in January 2002, and, in the wake of Enron's bankruptcy filing, attention turned to provisions like the securitization safe harbor contained in § 912 of the Bankruptcy Reform Act, which were removed because it was feared that they might facilitate financial deception. *Id.* Differences also remained over a provision capping homestead exemptions, and another making debts resulting from violent protests at abortion clinics non-dischargeable. *Id.* The Republicans then proposed a compromise. *See* Rep. F. James Sensenbrenner, Jr., Remarks before the Credit Union National Association (Feb. 27, 2002), available at <http://www.house.gov/judiciary/sensenbrenner022702.htm> (last visited Feb. 25, 2003). In August, an agreement was reached on the homestead cap, and Representative Hyde and Senator Schumer reached an agreement on the abortion clinic violence provision, but right-to-life members of Congress were not satisfied by that language. *See* Juliet Eilperin, *Abortion Fight Might Scuttle Bankruptcy Bill*, WASH. POST, Sept. 13, 2002, at A1. The Bill ultimately died during the lame duck session, when the House leadership was unable to get a majority to bring the Conference Report to a vote. Congress then voted out a version of the Bill which deleted the abortion clinic violence provision. The Senate, however, declined to act on that version of the Bill. The Bill is likely to be introduced at some point during the next Congress, but whether it will contain the Leahy Amendment is impossible to predict.

7. *See* LAWRENCE LESSIG, CODE AND OTHER LAWS OF CYBERSPACE 160 (1999).



privacy through propertization are legally and intellectually incoherent for a common reason. *Both focus on remedy without paying sufficient attention to the substantive privacy norms at stake.*

The Toysmart story and its legislative coda raise three related questions, each of which implicates a common failing in bankruptcy law and in the scholarly literature on data privacy. First, should an entitlement to data privacy be protected by a crystalline legal rule or a muddier standard?<sup>8</sup> Second, should privacy be protected as a property right or merely by liability-based civil damages?<sup>9</sup> And, third, does the answer to either of these questions change when a dot-com becomes insolvent?<sup>10</sup> The weakness of current law and current scholarship is that scholars, judges, and legislators focus separately on the content of the right to personal data privacy,<sup>11</sup> and on the status of that right as property or liability.<sup>12</sup> They fail to

8. See Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 592 (1988) (reviewing the debate between advocates of crystalline rules and advocates of muddy standards in connection with property law); see also *infra* note 38.

9. See Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1089 (1972).

10. For an introduction to the so-called "judgment proof" problem, see Steven Shavell, *The Judgment Proof Problem*, 6 INT'L REV. L. & ECON. 45, 45 (1986) ("An injurer will treat liability that exceeds his assets as imposing an effective financial penalty only equal to his assets ...."). See also Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1, 3 (1996). LoPucki analogizes the risk of loss to a card game:

Think of the liability system as a poker game .... Players risk their chips, that is, their wealth, by tossing them into the pot, that is, investing them in liability-generating economic activity. Chips contributed to the pot are at risk of loss; the system can take them to satisfy liability. Chips withheld are not at risk.

*Id.*

11. The privacy literature focuses on the development of "Fair Information Principles," or "FIPs," largely without regard to whether the remedy should be based in liability or property. Joel R. Reidenberg, *Setting Standards for Fair Information Practices in the U.S. Private Sector*, 80 IOWA L. REV. 497, 504-06 (1995); Marc Rotenberg, *Fair Information Practices and the Architecture of Privacy (What Larry Doesn't Get)*, 2001 STAN. TECH. L. REV. 1, 26-39 (2001), available at [http://stlr.stanford.edu/STLR/Articles/01\\_STLR\\_1](http://stlr.stanford.edu/STLR/Articles/01_STLR_1) (last visited Feb. 25, 2003); Paul M. Schwartz, *Privacy and Participation*, 80 IOWA L. REV. 553 (1995); see also FED. TRADE COMM., *PRIVACY ONLINE: A REPORT TO CONGRESS 7-14* (1998) (discussing "fair information practice principles").

12. As discussed below, the Bankruptcy Code treatment of privacy promises turns on whether the right is characterized as property or contract based. 11 U.S.C. §§ 363, 365 (2000). Indeed, some privacy scholars, Larry Lessig among them, see propertization of personal information as the solution to the Toysmart problem. See LESSIG, *supra* note 7, at 160. According to Lessig:

The law would be a kind of property right in privacy. Individuals must have both the ability to negotiate easily over privacy rights and the entitlement to

consider how the substantive content of a right interacts with its remedy. Most importantly, however, they fail to consider how right interacts with remedy when the debtor goes bankrupt.<sup>13</sup>

In this Article, I use personal information transactions and the treatment of privacy policies in bankruptcy as a frame to demonstrate that it is impossible to solve (1) the "right" problem (crystals v. mud), (2) the "remedy" problem (property v. liability), or (3) what economists call the "judgment proof" problem, in isolation.<sup>14</sup> Instead, I propose a mechanism based on "muddy property rights" that has the potential, over time, to solve all three problems together. I conclude that liability-based approaches to personal information transactions will not provide sufficient protection to website customers when a dot-com becomes insolvent or files for bankruptcy. It is premature, however, to develop a bright-line property entitlement that establishes the scope of data privacy rights in bankruptcy. Neither Congress nor the courts are likely to know the correct rule. E-commerce transactions are new, and the uses and abuses of personal data in the information economy are moving targets. Indeed, privacy policies that prohibit data disclosure, like the Toysmart policy, have virtually disappeared from the marketplace. As a result, any rule adopted today is likely to be wrong a year from now. Instead, I propose a general framework for thinking about data privacy in bankruptcy based on "muddy property rights." I argue that muddy property will encourage generation of information within the legal system about transactions in personal information and will encourage the piecemeal articulation (largely by bankruptcy judges) of appropriate legally enforceable norms for such transactions. Crystallization may follow, but with the benefit of more information and, perhaps, with fewer train wrecks along the way.

*"Remedy" divorced from "right."* Perhaps perversely, untangling the treatment of privacy policies in bankruptcy begins with remedy rather than right. In his provocative book, *Code and Other Laws of*

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privacy as a default. That is property's purpose: it says to those who want, you must negotiate before you can take. P3P is the architecture to facilitate that negotiation; the law is the rule that says negotiation must occur.

*Id.*

13. See *infra* notes 90-144 and accompanying text.

14. See Shavell, *supra* note 10, at 45.

*Cyberspace*, Larry Lessig proposes to solve the problem of privacy in cyberspace by propertizing nonpublic personal information.<sup>15</sup> On the one hand, while bankruptcy illustrates the necessity of a property-based protection for privacy rights, the task may not be as simple as he thinks. Propertization has some crucial benefits, but it also has some serious costs. The bankruptcy treatment of privacy policies turns on whether a privacy policy creates a right enforceable only through civil damages, or a right with the status of property.<sup>16</sup> If bankruptcy courts treat privacy policies solely as contract obligations, the debtor will be free to breach (or reject) the contract in bankruptcy.<sup>17</sup> Any damage claim will be treated as a prepetition claim,<sup>18</sup> paid, if at all, at a significant discount.<sup>19</sup> Consumer expectations of privacy, contractual or otherwise, are likely to be defeated.<sup>20</sup> By contrast, if personal information is deemed *property* subject to a license or encumbrance, then the property interest must be respected, or to use the bankruptcy term, given "adequate protection."<sup>21</sup> At first glance, this seems to be an improvement. Unfortunately, there is no well-developed mechanism for determining the meaning of adequate protection in the context of a sale of personal data, or for selling the data free of multiple overlapping property interests.<sup>22</sup> A so-called "anticommons" may result from these overlapping vetoes, stifling information transfers, and depriving debtors of a valuable asset.<sup>23</sup> Neither characterization fits well, and any attempt to shoehorn e-commerce

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15. LESSIG, *supra* note 7, at 160.

16. See *infra* text accompanying note 71.

17. See 11 U.S.C. § 365(a) (2000).

18. *Id.* § 365(g).

19. *Id.* § 502.

20. See *infra* text accompanying notes 90-109.

21. 11 U.S.C. § 361.

22. *Id.* § 363(f). Section 365(f) provides a mechanism for selling property free and clear of other interests, but for reasons that I will discuss below, the unsettled status and form of rights to use and sell personal information are sufficiently ill-formed that this section does not work well, and under current case law may not work at all. See *Gouveia v. Tazbir*, 37 F.3d 295, 299 (7th Cir. 1994) (holding that debtor is unable to sell land free and clear of restrictive covenants).

23. See Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621, 624 (1998) ("When there are too many owners holding rights of exclusion, the resource is prone to underuse—a tragedy of the anticommons."); see also Edward J. Janger, *Privacy Property, Information Costs and the Anticommons*, 54 HASTINGS L.J. (forthcoming 2003).

privacy policies into either the pure property or the pure liability category has significant costs. Bright-line property-based protection fails because coordination problems exist and the entitlement's content is unformed. Liability-based protection fails because, in bankruptcy, liability-based protection is no protection at all.

Bankruptcy law is not the only doctrinal ship to run aground on the shoals of the property/liability distinction. This Article is informed by, and seeks to inform, a broader discussion among non-bankruptcy scholars, begun by Guido Calabresi and A. Douglas Melamed, about the proper status of entitlements as property or liability.<sup>24</sup> Property rules are viewed as reflecting undivided entitlements. They allocate, as Carol Rose puts it, the "whole meatball" to the owner.<sup>25</sup> Liability rules, by contrast, are viewed as dividing an entitlement between two parties. One party holds the right, but the other party is given the option to take the right and compensate the right holder for the deprivation, in other words, to breach and pay damages.<sup>26</sup> Like the Bankruptcy Code, Calabresi and Melamed focus on remedy and the optimal line between property and liability. They seek to draw that line according to the relative costs of bargaining over the various rights. When bargaining is cheap and information symmetric, property rules predominate. When bargaining is costly, liability rules predominate.<sup>27</sup>

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24. See Calabresi & Melamed, *supra* note 9, at 1092. Calabresi and Melamed framed the issue as follows:

The state not only has to decide whom to entitle, but it must also [decide] the manner in which entitlements are protected and ... whether an individual is allowed to sell or trade the entitlement. In any given dispute, for example, the state must decide not only which side wins but also the kind of protection to grant.

*Id.* The set of "liability" rules goes beyond contract-based rights, and includes tort-based liability as well. In this regard, tort claims suffer the same fate in bankruptcy as contract-based claims, and could be subjected to virtually the same analysis. See Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 VA. L. REV. 1887, 1896-1916 (1994).

25. Carol M. Rose, *The Shadow of The Cathedral*, 106 YALE L.J. 2175, 2179 (1997).

26. See *id.* at 2178-79.

27. Calabresi & Melamed, *supra* note 9, at 1106. Professors Calabresi and Melamed note: In terms of economic efficiency the reason is easy enough to see. Often the cost of establishing the value of an initial entitlement by negotiation is so great that even though a transfer of the entitlement would benefit all concerned, such a transfer will not occur. If a collective determination of the value were available instead, the beneficial transfer would quickly come about.

*Id.*

Lessig's Calabresian focus on remedy follows Coase<sup>28</sup> and mirrors the Bankruptcy Code<sup>29</sup> in assuming that the shape and allocation of the underlying substantive entitlements are irrelevant—or at least comfortably exogenous.<sup>30</sup> Lessig argues that an efficient allocation of the bundle of sticks can be reached, one way or another, by private negotiation, either pre- or post-deprivation. A market transaction, however, is not always an efficient device for allocating entitlements, and negotiations are not costless. Mass market consumer contracts raise complex issues of adhesion, cognition, information asymmetry, and coordination.<sup>31</sup> E-commerce transactions involving personal information fall squarely within this class of problematic transactions. Where market imperfections are the norm, one cannot rely on private negotiations or markets to generate the appropriate terms or substantive norms for data sharing relationships.<sup>32</sup> Although a website customer may "consent" in some vague way to disclose personal information, it is unrealistic to expect such a transaction to carry with it a full comprehension of the ways the website owner might use such data. In consumer contracts, those legal obligations which are not mandated by law

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28. Ronald M. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 2-15 (1960) (arguing that in a world free of transaction costs, original entitlement questions are not relevant to the question of how assets are deployed because they will end up in the hands of the highest-value user). Unlike many of his followers, it is not clear that Coase himself believes that these assumptions mirror reality. See *infra* note 162.

29. See *Butner v. United States*, 440 U.S. 48, 54 (1979) (stating "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law").

30. See LESSIG, *supra* note 7, at 7-8, 63-100.

31. See Margaret Jane Radin, *Humans, Computers and Binding Commitment*, 75 IND. L.J. 1125, 1148-49 (2000). Professor Radin explains:

Market-emergent schemes of uniform contracts, on the other hand, have to some courts and commentators looked like a property scheme imposed by private companies for their own interests instead of by the government for the interest of all. In other words, in public choice rhetoric, the traditional view has been that legislative enactment is presumptively efficiency-enhancing, and market emergence is presumptively rent-seeking. Because market-emergent sets of terms are dictated by one party rather than arrived at by negotiation between the parties, they have been dubbed contracts of adhesion, or take-it-or-leave-it contracts.

*Id.* See generally Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173 (1983) (arguing that contracts of adhesion should be presumed to be unenforceable).

32. See *infra* text accompanying notes 176-80.

are formed by adhesion or default.<sup>33</sup> These obligations therefore will be defined by legislatures,<sup>34</sup> courts, or if shrink-wrap licenses are to be enforced, by the seller/licensor.<sup>35</sup>

Thus, Lessig's focus on remedy, or the "status" of the entitlement, and on bargaining as the method for defining and allocating entitlements ignores the inadequacy of bargaining in the privacy context. It is necessary to describe an alternative mechanism<sup>36</sup> for generating substantive rules to govern personal information transactions, and more importantly, to identify the appropriate institutional source for those substantive rules and the appropriate locus of enforcement.

"*Right divorced from "remedy."* In an earlier article, I sought to show that muddy and crystalline rules are the gatekeepers of institutional choice.<sup>37</sup> In our legal system, the interaction among courts, legislatures, and the market depends on how substantive entitlements are structured.<sup>38</sup> Whether entitlements will be generated or

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33. See Rakoff, *supra* note 31, at 1183-96.

34. Where defaults are set by government, they may be waivable or mandatory. For a discussion of the role of waivable defaults in data privacy transactions, see Edward J. Janger & Paul M. Schwartz, *The Gramm-Leach-Bliley Act, Information Privacy, and the Limits of Default Rules*, 86 MINN. L. REV. 1219 (2002). Also note that consumer protection law consists of a combination of sticky defaults and mandatory rules. See U.C.C. § 2-316 (2001); Stephen J. Ware, *Consumer Arbitration As Exceptional Consumer Law (With a Contractualist Reply to Carrington & Haagen)*, 29 MCGEORGE L. REV. 195, 206-09 (1998) (describing the principal types of mandatory consumer protection law). See generally MICHAEL M. GREENFIELD, CONSUMER TRANSACTIONS (2d ed. 1991); DOUGLAS J. WHALEY, PROBLEMS AND MATERIALS ON CONSUMER LAW (1991).

35. Compare *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1148-51 (7th Cir. 1997) (holding that terms sent in computer shipping box were binding on buyer who failed to return the computer within the thirty days stipulated by those terms), and *ProCD, Inc. v. Zeidenberg*, 86 F.3d 1447, 1448-53 (7th Cir. 1996) (holding that terms inside a package of software bind the customer who used the software after having had the opportunity to reject the terms by returning the goods), with *Step-Saver Data Systems, Inc. v. Wyse Techs.*, 939 F.2d 91, 95-106 (3d Cir. 1991) (holding that a disclaimer on a software package did not become a term of agreement between buyer and seller).

36. Possible bases include hypothetical consent (i.e., a majoritarian default), efficiency, or fairness. The point here is that any attempt to ground the norms for sharing personal data in e-commerce transactions in consent is doomed to incoherence and subject to abuse.

37. Edward J. Janger, *Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design*, 43 ARIZ. L. REV. 559 (2001).

38. See Rose, *supra* note 8, at 600. Competing views of the relative merits of "rules and standards" are discussed in RICHARD A. POSNER, *THE PROBLEMS OF JURISPRUDENCE* 42-61 (1990); Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557 (1992); Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L.

defined by legislatures, courts, or the market is determined by the choice between crystals and mud (or rules and standards).<sup>39</sup> A crystalline rule places all of the relevant rights firmly in the hand of the entitlement holder or "owner." A muddier standard leaves the right subject to challenge by a competing claimant. Crystalline rules situate decision-making and norm-generating authority in either the legislature or the market. Muddy rules lead to judge-made decisions and legal norms articulated by judges.<sup>40</sup>

Just as the property/liability literature ignores the choice between crystals and mud, however, the literature on the shape of substantive entitlements ignores the choice of remedy. In short, both literatures fail to systematically explore the interaction between substantive rights, which can be crystalline or muddy in form, and remedies, which give a legal norm the status of either property or liability. Although Lessig ignores substantive privacy norms,<sup>41</sup> privacy scholars critical of Lessig like Marc Rotenberg and Jessica Litman, have tended to focus on the privacy entitlement without regard to the reality that liability-based entitlements go unenforced in bankruptcy.<sup>42</sup>

*Norm nonenforcement in bankruptcy.* Finally, although both bankruptcy scholars and law and economics scholars recognize that insolvency dilutes the liability rules' ability to enforce legal norms, there is no consensus about how to respond.<sup>43</sup> Law and economics scholars tend to focus on property rights as a solution, whereas bankruptcy scholars resist the creation of new property rights because they interfere with bankruptcy law's collective norm of

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REV. 1685, 1687-1712 (1976); Pierre Schlag, *Rules and Standards*, 33 UCLA L. REV. 379 (1985).

39. As a matter of terminology, I use the terms "rules" and "crystals" as synonyms, and "mud" and "standards" as synonyms. At times I will even use the terms "muddy standards," and "crystalline rules." From time to time, however, the demands of a particular sentence will cause me to refer to a "muddy rule," or to refer to a choice between "crystalline and muddy rules." This is not intended as an oxymoron. In that construction, I am merely using the word "rule" in its generic sense, to refer to an enforceable legal norm, regardless of its form.

40. See Janger, *supra* note 37, at 581-82.

41. See LESSIG, *supra* note 7.

42. Compare Reidenberg, *supra* note 11, at 504-06, Rotenberg, *supra* note 11, at ¶¶ 19-38, and Schwartz, *supra* note 11, at 574-82, with LESSIG, *supra* note 7, at 142-63.

43. Privacy scholars appear to have missed this point entirely. See *infra* text accompanying note 196.

equal distribution and maximization of value through reorganization.<sup>44</sup> Again, the incoherence of the debate turns on the failure to focus on the substance of the norm in question and the institution which will articulate it.<sup>45</sup>

*"Muddy property," norm articulation, and norm enforcement—a synthesis.* The "muddy property" mechanism that I propose draws on the law and economics literature of property and liability rules and the literature of rules and standards, and suggests a synthesis. As I have discussed in my earlier work, muddy standards force parties *ex ante* to recognize that they might have to justify their contractual terms and negotiating behavior *ex post*.<sup>46</sup> This attribute of muddy rules operates to enforce behavioral norms in ways that crystalline rules do not.<sup>47</sup> Efforts to resolve norm-based disputes force disclosure of information related to the norm. This norm-based information-forcing effect has both public and private implications. Muddy rules may improve the contracting behavior of parties, but muddy rules also serve a more public purpose: they force information about transactions into the legal system.<sup>48</sup> They allow judges to develop rules incrementally through common law reasoning, and inform legislative decision making by placing disputes on the record.<sup>49</sup> But muddiness alone is not enough. The benefits of the muddy liability rule may evaporate entirely when a debtor goes bankrupt. These behavior-regulating and information-forcing effects of muddy rules are maximized only when the muddy rule is given the status of property.

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44. Compare LoPucki, *supra* note 10, at 25-26, and Lynn M. LoPucki, *The Irrefutable Logic of Judgment Proofing: A Reply to Professor Schwarcz*, 52 STAN. L. REV. 55, 55-67 (1999) [hereinafter LoPucki, *Reply to Schwarcz*], with Steven L. Schwarcz, *Rethinking Freedom of Contract: A Bankruptcy Paradigm*, 77 TEX. L. REV. 515, 576-84 (1999) [hereinafter Schwarcz, *Freedom of Contract*], Steven L. Schwarcz, *The Inherent Irrationality of Judgment Proofing*, 52 STAN. L. REV. 1, 5-10, 51-53 (1999) [hereinafter Schwarcz, *Judgment Proofing*], and Steven L. Schwarcz, *Judgment Proofing: A Rejoinder*, 52 STAN. L. REV. 77, 77-85 (1999) [hereinafter Schwarcz, *Rejoinder*].

45. To a large extent, the impasse arises because the norm at issue in the securitization debate, repaying prepetition creditors, conflicts directly with a bankruptcy norm (equality of distribution). In this Article, I focus on privacy, a nonbankruptcy norm, and this results in a more productive conversation.

46. Janger, *supra* note 37 at 585; Rose, *supra* note 8, at 600.

47. See Janger, *supra* note 37, at 585.

48. See *infra* text accompanying notes 209-11.

49. See Janger, *supra* note 37, at 585-86.



This Article proceeds in four steps. First, I use the strong contractual privacy policy offered by Yahoo and Toysmart to describe current bankruptcy law, and demonstrate that the treatment of personal information in bankruptcy turns on whether privacy promises create a "claim," subject to discharge in bankruptcy,<sup>50</sup> or an "encumbrance" on personal information that survives the bankruptcy discharge.<sup>51</sup> I then seek to show that the distinction between property and liability does not work well for characterizing privacy policies. Second, I show that cognitive problems, coordination problems, and information asymmetries have prevented the development of a functioning market for privacy policies and practices. The Toysmart privacy policy is not the norm. Most website privacy policies detail the manner in which information will be used, not the ways in which it will be protected. In this second Section, I also show that shifting from liability to property will not solve the problem. Policymakers must pay more attention to defining the underlying substantive privacy entitlement and, more importantly, to the institutional process for formulating that entitlement.<sup>52</sup> Third, I attempt to develop a theory of the information-forcing effect of muddy rules. I argue that muddy standards, and muddy property rules in particular, have the effect of forcing out norm-related information. Further, I suggest that such norm-related information-forcing is necessary if we are to articulate appropriate rules for dealing with consumer privacy promises in bankruptcy. Finally, in the fourth Section, I evaluate the Leahy Amendment to the Bankruptcy Reform Bill in light of this discussion.<sup>53</sup> I argue that on the one hand, the Leahy Amendment

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50. 11 U.S.C. § 101(5) (2000).

51. *Id.* § 506.

52. One notable exception is Richard Craswell, whose excellent article, *Property Rules and Liability Rules in Unconscionability And Related Doctrines*, explores the interaction between substantive rules of contract intended to police consent and remedial choice. Richard Craswell, *Property Rules and Liability Rules in Unconscionability and Related Doctrines*, 60 U. CHI. L. REV. 1 (1993); see also John E. Calfee & Richard Craswell, *Some Effects of Uncertainty on Compliance with Legal Standards*, 70 VA. L. REV. 965, 968-69 (1984) (arguing that uncertainty in the legal process does not force defendants to choose between two extremes of liability, but rather that there is a spectrum of choice that will result in different degrees of liability). Even Craswell, however, has not tried to think through the effect that choice of remedies can have on articulation of noncontractual norms, and how the presence of uncertainty on the norm side affects the choice of remedy.

53. See *supra* note 6 (discussing the status of the Bankruptcy Reform Bill).

points the way (imperfectly and incompletely) toward a more nuanced understanding of the interaction between right and remedy by creating a "muddy property rule." On the other hand, I conclude that the Leahy Amendment ultimately fails, both because it defers excessively to the market, and because it represents a complete abdication by the legislature of its obligation to give some shape to the privacy norms it ostensibly seeks to protect. I then propose an alternative approach which links the concept of muddy property to the emerging law of fair information practices (FIPs).

### I. BANKRUPTCY LAW, BANKRUPTCY LAWLESSNESS

In the information privacy context the *Toysmart* case highlights an aspect of bankruptcy law and insolvency that periodically outrages the public, continually puzzles bankruptcy scholars, and feeds armies of bankruptcy lawyers. Bankruptcy law is sometimes perceived by debtors and nondebtors alike as a device for running away from contractual obligation. Burger King franchises have sought to get out from under their franchise agreements.<sup>54</sup> Rock stars have sought to renegotiate their contracts with record companies.<sup>55</sup> Now websites seek to sell customer lists out from under privacy policies.

Bankruptcy judges and bankruptcy scholars have long attempted to untangle this web. They recognize that some rights need to be enforced, notwithstanding the debtor's insolvency, whereas other rights can be modified for the benefits of creditors. Jay Westbrook, in his extraordinary article, *A Functional Analysis of Executory Contracts*,<sup>56</sup> demonstrates that regardless of what a right is called,

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54. See, e.g., *Burger King Corp. v. Rovine Corp.* (*In re Rovine Corp.*), 5 B.R. 402, 404 (Bankr. W.D. Tenn. 1980).

55. See, e.g., *In re James Taylor* (*James Taylor*), 913 F.2d 102 (3d Cir. 1990); *In re Watkins*, 210 B.R. 394 (Bankr. N.D. Ga. 1997) (TLC); *All Blacks B.V. v. Gruntruck*, 199 B.R. 970, 971-72 (Bankr. W.D. Wash. 1996); *In re Noonan*, 17 B.R. 793 (Bankr. S.D.N.Y. 1982) (*Willie Nile*); A. Mechelle Dickerson, *Lifestyles of the Not-So-Rich or Famous: The Role of Choice and Sacrifice in Bankruptcy*, 45 BUFF. L. REV. 629 (1997); David C. Norrell, Note, *The Strong Getting Stronger: Record Labels Benefit from Proposed Changes to the Bankruptcy Code*, 19 LOY. L.A. ENT. L. REV. 445 (1999); see also Todd M. Murphy, Note, *Crossroads: Modern Contract Dissatisfaction as Applied to Songwriters and Recording Agreements*, 35 J. MARSHALL L. REV. 795 (2002); cf. *In re Carrere*, 64 B.R. 156 (Bankr. C.D. Cal. 1986) (recounting bankruptcy suit of actress Tia Carrere).

56. Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L.

the demarcation between enforcement and nonenforcement largely falls along the line between rights protected by a civil damage remedy (liability), and rights that are enforceable by affirmative judicial order or criminal sanction (property), what Westbrook calls an "Interest in the Thing Itself" or "ITI."<sup>57</sup> If the nondebtor has a liability-based claim, it can be discharged in bankruptcy. If the nondebtor holds a property right that can be enforced against third parties, it must be respected in bankruptcy. There is a problem with this division, however, and it is one that Westbrook himself recognizes. Nonbankruptcy entitlements are not generally created or defined with the property/liability distinction in mind.<sup>58</sup> As a result, enforcement of nonbankruptcy norms in bankruptcy becomes haphazard at best.

Privacy policies prove to be a productive setting for thinking about this larger bankruptcy problem. First, although privacy policies are principally creatures of contract,<sup>59</sup> there are nascent elements of property that pervade the relationship. As such, one can articulate plausible lawyers' arguments for property-based treatment, and can explore the implications of the competing "contract" and "property" characterizations. Second, because privacy policies are a product of the new and emerging law of cyberspace, the underlying behavioral norms, transactional risks, and public policy concerns are not fully understood. This facilitates exploration of how the form and status of an entitlement interact when a debtor is insolvent. To anticipate somewhat, I seek to show that unless privacy norms are protected with a property rule, they will go unenforced in bankruptcy, and because most privacy policies are not as hard-edged as Toysmart's, a muddy entitlement will encourage public *and* private dialogue about the privacy norms that should govern consumer data transactions.

In this Section, I use Yahoo's rather unusual privacy policy as a frame for describing various possible treatments of privacy promises in bankruptcy, and to highlight the consequences of

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REV. 227, 257-63 (1989).

57. *Id.* at 246.

58. *Id.* at 270 ("The analysis becomes complex in these cases when nonbankruptcy law is unclear about the Other Party's right to [an Interest in the Thing Itself or "ITI"].").

59. In the absence of a contract, privacy rights lie in tort. See Samuel D. Warren & Louis D. Brandeis, *The Right to Privacy*, 4 HARV. L. REV. 193, 210-11 (1890).

characterizing privacy policies as property or contract. In the next sections, I seek to disentangle uncertainty about the status of entitlements (property/liability) from uncertainty about the shape of the entitlements (crystals/mud). I argue first that little is gained from uncertainty about status, but that a muddy formulation of the substantive norm at stake can have important benefits. Second, I argue that the choice between crystals and mud should be made in conjunction with the property/liability decision, with instincts about comparative institutional competence at the fore.

### *A. Privacy Promises in the Real World*

As noted above, the answer to Headcold's question about Yahoo's privacy policy begins with *Toysmart*.<sup>60</sup> Toysmart was a dot-com, started with the backing of the Walt Disney Corporation, that sought to sell educational toys to children and their parents over the World Wide Web. In the process of selling toys, Toysmart gathered information both about adults and about children.<sup>61</sup> To encourage a feeling of comfort in their customers, Toysmart posted a privacy policy on their website that, like Yahoo's policy, stated they would "never" sell nonpublic, personally-identifiable information about customers to third parties. This privacy policy was unusual. Many dot-coms view selling data as part of their business model, and therefore post privacy policies that leave much more room for sale of personal information. Notwithstanding this unusually restrictive privacy policy, when Toysmart's liquidation consultant, The Recovery Group, advertised the sale of various Toysmart assets, they included the company's customer list.<sup>62</sup>

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60. See *In re Toysmart.com, LLC*, No. 00-13995-CJK (Bankr. D. Mass. filed June 9, 2000).

61. They ran a "dinosaur trivia contest" through which they gathered information about children who visited the site. Complaint, *FTC v. Toysmart, LLC*, No. 00-11341-RGS (Mass. Dist. Ct. filed July 10, 2000), available at <http://www.techlawjournal.com/courts/toysmart/20000710.htm> (last visited Feb. 25, 2003) (detailing Toysmart's information-gathering practices).

62. Jane Kaufman Winn & James R. Wrathall, *Who Owns The Customer? The Emerging Law of Commercial Transactions in Electronic Customer Data*, 56 *BUS. LAW.* 213, 227 (2000).

Toysmart.com had retained the services of The Recovery Group, a Boston management consultant, in an effort to find buyers for its assets. A *Wall Street Journal* advertisement for Toysmart.com's asset sale listed, among other things: "Intangibles, i.e., URL name, databases, customer lists, marketing plans, web site content, [and] software intellectual property."

Prior to filing for bankruptcy, Toysmart had entered into a contract with Trust-e.<sup>63</sup> Trust-e is a so-called "privacy seal service"—a nonprofit organization that provides privacy auditing services.<sup>64</sup> Trust-e's contract provided that Toysmart.com could display the Trust-e logo on its website, but only if they complied with certain guidelines, and only if Toysmart complied with its own published privacy policy. Toysmart's decision to sell its customer list in violation of its privacy policy put Trust-e's credibility and, indeed its entire franchise, on the line. If websites using the Trust-e logo could file for bankruptcy and then turn around and sell personal information with impunity, Trust-e certification would be worthless. Trust-e brought Toysmart's proposed sale to the attention of the Federal Trade Commission (FTC). The FTC sued Toysmart in the Federal District Court for the District of Massachusetts, and the sale was temporarily stopped.<sup>65</sup> Toysmart then negotiated a settlement with the FTC, under which Toysmart agreed that it would only sell the information to a company that would provide appropriate protection, and which would make use of the information in a manner similar to that of Toysmart.<sup>66</sup> The bankruptcy judge rejected the settlement as premature, because

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*Id.* The Toysmart case was widely reported at the time. See Matt Richtel, *Toysmart.com in Settlement with F.T.C.; Deal Would Allow Sale of Customer Database*, N.Y. TIMES, July 22, 2000, at C1; see also Laura Lorek, *When Toysmart Broke*, INTERACTIVE WK. FROM ZDWIRE, Aug. 7, 2000, available at 2000 WL 4067740.

63. See <http://www.Truste.com>.

64. Trust-e has been described as a sort of Good Housekeeping Seal of Approval for the Web. More than 2000 sites have been certified by Trust-e as having met certain criteria for safeguarding customer privacy. See Greg Sandoval, *Failed Dot-Coms May Be Selling Your Private Information*, CNET NEWS.COM, June 29, 2000, at <http://news.cnet.com/news/0-1007-200-2176430.html> (last visited Feb. 25, 2003).

65. Complaint, FTC v. Toysmart.com, LLC, No. 00-11341-RGS (Mass. Dist. Court filed July 10, 2000), available at <http://www.techlawjournal.com/courts/toysmart/20000710.htm> (last visited Feb. 25, 2003). Because some of that customer data had been collected from children through a "dinosaur trivia contest" without parental consent or notification, the complaint also charged that Toysmart.com had violated the Children's Online Privacy Protection Act, 15 U.S.C. § 6503 (2000) and 16 C.F.R. §§ 312.3-312.5 (2002). *Id.*

66. See Toysmart Stipulation, *supra* note 4; see also Press Release, FTC Announces Settlement with Bankrupt Website, Toysmart.com, Regarding Alleged Privacy Policy Violations (July 21, 2000), available at <http://www.ftc.gov/opa/2000/07/toysmart2.htm> (last visited Feb. 25, 2003); Stephanie Stoughton, *Toysmart Offer Hit By Advocates: Say Disney Bid to Buy, Retire Customer List Doesn't Ensure Privacy*, THE BOSTON GLOBE, July 14, 2000, at C1; *Toysmart.com Settles Case About Sale of Users' Data*, THE DESERET NEWS, July 22, 2000, at B06.

no buyer was waiting in the wings.<sup>67</sup> The end result of the case was that Disney, possibly as a public relations move, agreed to pay \$50,000 to the Toysmart estate to destroy the data.<sup>68</sup> Notwithstanding Toysmart's initial optimism about using bankruptcy law to help realize the value of the customer lists, the attempt failed.

Outside of bankruptcy, personal data sales have been in the news as well. In the fall of 2000, hoping to preserve its ability to sell customer data in the wake of Toysmart, Amazon.com changed its privacy policy and expressly notified its customers that it would sell customer data from time to time as part of its business.<sup>69</sup> More recently, e-Tour.com, an Internet portal with a privacy policy similar to Toysmart's, sold all of its assets to Ask-Jeeves.com, including customer lists, outside of bankruptcy. The Electronic Privacy Information Center filed a complaint with the FTC, and that story continues to unfold.<sup>70</sup>

A curious aspect of the Toysmart story, however, is that it was not bankruptcy law or contract law per se that chilled the sale of customer information. It was nonbankruptcy state and federal law, a government agency, and a bankruptcy judge all working together that led to the *Toysmart* result. Indeed, the Bankruptcy Code had virtually nothing to do with the result. Moreover, privacy policies like Toysmart's (and Yahoo's) are increasingly unusual. As noted above, websites now tend to use privacy policies as a means to justify disclosure, rather than as a guaranty of privacy protection.

To understand how to deal with future cases, it is necessary to pull apart these layers. Both inside and outside of bankruptcy, the legal framework for dealing with transactions in personal data is up

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67. *Top Stories, Privacy: Bankruptcy Judge Rejects FTC Settlement Under New Child Privacy Law: FTC v. Toysmart.com*, 11 ANDREWS E-BUS. L. BULL. 1 (2000) [hereinafter *Top Stories*].

68. Thirty-eight state attorneys general, who had objected to the sale along with the FTC, also agreed to this disposition. National Association of Attorneys General, *Thirty-eight Attorneys General Reach Agreement With Toysmart*, NAAG CONSUMER PROTECTION REP., Jan. 2001, at 4.

69. Tamara Loomis, *Amazon Revamps Its Policy on Sharing Data*, 224 N.Y. L.J. 5 (2000) (noting changes in Amazon.com's privacy policy in response to the *Toysmart* case).

70. See Letter from Marc Rotenberg and Andrew Shen to National Association of Attorneys General and Federal Trade Commission (May 25, 2001), available at <http://www.epic.org/privacy/internet/etour.html> (last visited Feb. 21, 2002).

for grabs. The status of privacy policies, and the limits on sale notwithstanding the absence of a privacy policy, are both uncertain.<sup>71</sup>

### *B. The Law: Outside of Bankruptcy*

For the most part, a debtor's rights and obligations in bankruptcy are determined by applicable nonbankruptcy law.<sup>72</sup> Answering Headcold's question about what happens to Yahoo's privacy policy in bankruptcy requires, as a threshold matter, an analysis of Headcold's question outside of bankruptcy. Until recently, and in the absence of the privacy policy, the answer would have been simple. Except to the extent that it might have been governed by medical privacy rules, Yahoo could have sold customer information at will.<sup>73</sup> As sensitivity about web-based businesses' ability to collect information about customers has increased, and as technology has allowed businesses to aggregate customer data in new ways,<sup>74</sup> there has been a growing layer of regulation governing the gathering and dissemination of customer data. For example, the Gramm-Leach-

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71. Recent discussions of this issue include Stephen F. Ambrose, Jr. & Joseph W. Gelb, *Consumer Privacy Regulation and Litigation*, 56 BUS. LAW. 1157 (2001); Jane Kaufman Winn & James R. Wrathall, *Who Owns the Customer? The Emerging Law of Commercial Transactions in Electronic Customer Data*, 56 BUS. LAW. 213 (2000); Andrew B. Buxbaum & Louis A. Curcio, Note, *When You Can't Sell to Your Customers, Try Selling Your Customers (But Not Under The Bankruptcy Code)*, 8 AM. BANKR. INST. L. REV. 395 (2000); see also Steven A. Hetcher, *The Emergence of Website Privacy Norms*, 7 MICH. TELECOMM. & TECH. L. REV. 97 (2001), available at <http://www.mttlr.org/volseven/hetcher.html> (last visited Feb. 25, 2003).

72. See *Butner v. U.S.*, 440 U.S. 48, 54 (1979) ("Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law.").

73. Before the advent of the World Wide Web, companies freely bought and sold customer lists and customer information. See, e.g., *Moore v. Regents of the Univ. of Cal.*, 793 P.2d 479, 487 (Cal. 1990), cert. denied, 499 U.S. 936 (1991) (rejecting individual's claim of property right in his genetic information)); Pamela Samuelson, *Privacy as Intellectual Property*, 52 STAN. L. REV. 1125, 1131 n.31 (2000) (citing *Polin v. Dun & Bradstreet, Inc.*, 768 F.2d 1204, 1207 (10th Cir. 1985) (rejecting privacy claim based on unauthorized release of credit report information)).

74. See U.S. GEN. ACCOUNTING OFFICE, *SOCIAL SECURITY: GOVERNMENT AND COMMERCIAL USE OF THE SOCIAL SECURITY NUMBER IS WIDESPREAD* 7-12 (1999); see also Daniel J. Solove, *Digital Dossiers and the Dissipation of Fourth Amendment Privacy*, 75 S. CAL. L. REV. 1083 (2002) ("[T]here is increasingly a detailed series of records being created about almost every facet of a person's life, and these records can be easily stored, transferred, combined, and searched.").

Bliley Amendments to the Glass-Steagal Act<sup>75</sup> contain a number of provisions governing the disclosure of personal information by financial institutions,<sup>76</sup> the Video Privacy Protection Act,<sup>77</sup> and the European Union has promulgated a directive which governs international transfers of personal information from companies in the E.U. to companies in the United States.<sup>78</sup> All of these regimes, however, are *more* lenient than the highly restrictive, and somewhat unusual, policy that Yahoo imposed upon itself.<sup>79</sup> As such, the initial focus is on the constraint imposed by Yahoo's own privacy policy, which raises three issues: (1) is there an enforceable contract?, (2) what are the consequences of breach?, and (3) is the contract enforceable by specific performance?

The answers, outside of bankruptcy, are reasonably straightforward. Privacy policies are likely to be enforceable.<sup>80</sup> Even outside

75. Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102, 113 Stat. 1338 (1999). For a discussion of the various statutes governing dissemination of customer data, see Janger, *supra* note 23. See also PAUL M. SCHWARTZ & JOEL R. REIDENBERG, DATA PRIVACY LAW (1996); PAUL M. SCHWARTZ & JOEL R. REIDENBERG, DATA PRIVACY LAW SUPPLEMENT (1998).

76. These protections are found in the Gramm-Leach-Bliley Act's Title V. For a more detailed discussion of these provisions, see Janger & Schwartz, *supra* note 34.

77. 18 U.S.C. § 2710 (1994).

78. PETER P. SWIRE & ROBERT E. LITAN, NONE OF YOUR BUSINESS: WORLD DATA FLOWS, ELECTRONIC COMMERCE, AND THE EUROPEAN PRIVACY DIRECTIVE (1998); Paul M. Schwartz, *European Data Protection Law and Restrictions on International Data Flows*, 80 IOWA L. REV. 471 (1995); Spiros Simitis, *From the Market to the Polis: The EU Directive on the Protection of Personal Data*, 80 IOWA L. REV. 445, 463-66 (1995). The requirements for complying with the "Safe Harbor" negotiated between the European Union and the United States can be found at <http://www.export.gov/safeharbor/> (last visited Feb. 25, 2003).

79. It is important to recognize that the Yahoo/Toysmart/e-Tours hard-line privacy policy is not the only form that such policies take. "Hard" privacy policies, however, are not unknown, and they allow us to focus the analysis on the contract issues and their treatment in bankruptcy. This focus is essential if the goal of the enterprise is to create a legal regime where privacy issues will be resolved by private negotiation, and if one is to evaluate whether such a regime is feasible. See Janger & Schwartz, *supra* note 34.

80. Some website owners may argue that their privacy policies are not enforceable because they lack consideration. See RESTATEMENT (SECOND) OF CONTRACTS § 71 (1979) ("To constitute consideration, a performance or a return promise must be bargained for."); Walter W. Miller, Jr. & Maureen A. O'Rourke, *Bankruptcy Law v. Privacy Rights: Which Holds the Trump Card?*, 38 HOUS. L. REV. 777, 795 (2001). Courts will likely look past this argument, finding either that the exchange of information for a privacy promise constitutes sufficient consideration to make the contract enforceable, see RESTATEMENT (SECOND) OF CONTRACTS § 81 (1979) ("The fact that what is bargained for does not of itself induce the making of a promise does not prevent it from being consideration for the promise."), or that the website customer relied on the existence of a privacy policy in giving the information, even if they didn't read the policy itself. See *id.* § 90.



of bankruptcy, however, the limitations of a regime based on contractual liability become apparent. A damages-based regime is likely to undercompensate website customers, and underdeter data sales that violate privacy policies. The harm caused by nonconsensual data sales is largely dignitary, and the financial harm is both small and difficult to quantify.<sup>81</sup> Only in the aggregate are damages likely to be significant, and there are significant obstacles to any lawsuit that might aggregate such claims.<sup>82</sup> In short, some deterrence is likely, but the amount is not likely to be optimal.

Outside of bankruptcy, the contract might also be enforceable by specific performance. While courts generally favor compensatory damages as a remedy for contractual breach, in limited circumstances courts will compel performance of a contract by issuing an order of specific performance.<sup>83</sup> Specific performance is only

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81. Contract damages are compensatory in nature, and the consequences of breach are hard to determine in data privacy cases. RESTATEMENT (SECOND) OF CONTRACTS § 344 (1979) ("Judicial remedies [for breach of contract] serve to protect ... his 'expectation interest,' which is his interest in having the benefit of his bargain by being put in as good a position as he would have been in had the contract been performed ...."). While damages will turn on the nature of the information disclosed, in many cases, the information subject to the promise is of relatively little value insofar as it applies to a single person. It may just be the fact that the customer bought a certain type of shirt in a certain color and size from L.L. Bean. In the case of Yahoo, however, the information may be more sensitive (such as ordering a herbal remedy for bad breath). For a site like Yahoo, the harm is likely to be correspondingly greater, but it is still likely to be dignitary rather than monetary. Even for Yahoo, to the extent that a customer seeks compensation for loss suffered as a result of disclosure, the monetary damages will be relatively small. In the absence of a statute allowing for statutory or punitive damages, or a separate tort cause of action, the financial incentives associated with a liability regime are likely to understate the actual harm caused by a sale of data. *See Stern v. Delphi Internet Services Corp.*, 626 N.Y.S.2d 694 (N.Y. Sup. Ct. 1995) (detailing an unsuccessful attempt to use misappropriation theory to sue electronic bulletin board); DAN B. DOBBS, *THE LAW OF TORTS* 1198-1200 (2000).

82. The fact that each individual has such a small interest, and suffers such a small harm, creates a collective action problem that reduces the expected cost of any liability. The availability of class action procedures may help remedy this collective action problem. *See Supnick v. Amazon.com, Inc.*, 2000 WL 1603820 (W.D. Wash. 2000) (certifying class action against Amazon.com for violation of privacy policy in connection with Alexa software). Still, the risk of contract damages, though significant, will not reflect the full damage caused by such a transfer, and may not be sufficiently large to chill a data sale, and some courts have been hostile to class actions in cases where large databases are at issue. *See, e.g., In re Trans Union Corp. Privacy Litigation*, 2002 WL 31028234, at \*8-9 (N.D. Ill. Sept. 10, 2002) (holding class actions are not available under the Fair Credit Reporting Act).

83. RESTATEMENT (SECOND) OF CONTRACTS § 345 (1979) ("The judicial remedies available for the protection of the interests stated in § 344 include a judgment or order ... requiring

available when contract damages are inadequate.<sup>84</sup> Although it is likely that a court will conclude that they *are* inadequate, the court must still “balance the equities,” and decide whether the harm to the plaintiff outweighs the benefit to Yahoo.<sup>85</sup> It is hard to generalize in this instance. Courts are likely to be sensitive to the fact that the information compilation may be worth a lot to the company, and the harm of disclosure may be minimal.<sup>86</sup> Courts are also likely to weigh the promise not to disclose heavily, and to consider techniques for ameliorating the harm of the disclosure (such as providing a requirement to opt-in or an opportunity to opt-out).

Outside of bankruptcy, if a privacy policy is enforced with a liability rule, there is a significant risk of underdeterrence because of the principally dignitary nature of the harm, but the liability rule provides *some* protection because of the threat of liability in the aggregate. If rights under Yahoo’s privacy policy are characterized as property-based, these rights receive significantly more protection. The providers of personal information (Yahoo’s customers) will be able to veto any transfer of the information.<sup>87</sup> Indeed, outside of bankruptcy, it may be virtually impossible to obtain the consents necessary to permit a sale.<sup>88</sup>

Thus, whether Yahoo can sell the information will turn largely on whether the promise is deemed to be specifically enforceable—whether privacy policies are enforced by a liability rule or a property rule.

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specific performance of a contract or enjoining its non-performance ....”).

84. *Id.* § 359 (“Specific performance ... will not be ordered if damages would be adequate to protect the expectation interest of the injured party.”).

85. *Id.* The official comment to § 359 of the Restatement goes on to state: “Adequacy is to some extent relative, and the modern approach is to compare remedies to determine which is more effective in serving the ends of justice.” *Id.* § 359 cmt. a.

86. Complaint, *Judnick v. DoubleClick, Inc.*, No. CV-000421 (Cal. App. Dep’t Super. Ct. 2000) (alleging state law claims for placing cookies and creating personally identifiable profiles in violation of stated privacy policy).

87. However, specific performance is only available if suit is brought before the information is disclosed. Once the data is sold/disclosed, it cannot be unsold. In that case, again, the sole remedy would be damages. Only if personal information is granted property status could the limitation on use be extended to subsequent transferees.

88. For large databases, the cost of gathering consents may swamp the benefit. See *Heller*, *supra* note 23, at 624; see also *Janger*, *supra* note 23.

### *C. Privacy Promises in Bankruptcy*

While the distinction between property and liability makes a big difference to Yahoo outside of bankruptcy, this distinction between treatment of privacy promises as liability-based or property-based becomes paramount if Yahoo files for bankruptcy. If privacy promises are protected by civil damages, the privacy policy will provide no (or almost no) constraint on the sale of the information. By contrast, if the promise is treated as an encumbrance on the information enforceable in bankruptcy (i.e., "property"), bankruptcy court supervision of the debtor's assets will enhance the effect of property-based protection. No disclosure will be permitted without bankruptcy court approval, and there is no mechanism in place for obtaining such approval.<sup>89</sup> The result will be to frustrate asset sales.

#### *1. Liability Rules—Executory Contracts and Unsecured Claims in Bankruptcy*

It is a commonplace of bankruptcy law that liability claims are discharged,<sup>90</sup> and property rights are respected.<sup>91</sup> To understand the treatment of contracts in bankruptcy it is necessary to understand the distinction between "assets," "prepetition claims," and "executory contracts" in bankruptcy.<sup>92</sup> In a classic pair of articles, Vern Countryman demonstrated that a debtor's contractual obligations can be divided into four categories based on whether the parties' obligations are fully performed or remain

89. 11 U.S.C. § 363(f) (2000). The power to sell assets free and clear of liens is sometimes viewed as a mechanism for sweeping away encumbrances. However, as discussed below, without at least some statutory tweaking, it will not work well for privacy promises.

90. *Id.* § 524.

91. *Id.* §§ 361, 506; see also *Dewsnup v. Timm*, 502 U.S. 410 (1992).

92. This is not a trivial undertaking.

Bankruptcy is that volume of the law that might have been written by Lewis Carroll .... In no chapter of that volume has the law become more psychedelic than in the one titled 'executory contracts.' The courts increasingly voice cries of confusion and frustration over the treatment of contracts in bankruptcy.

Westbrook, *supra* note 56, at 228; see also Michael T. Andrew, *Executory Contracts in Bankruptcy: Understanding "Rejection,"* 59 U. COLO. L. REV. 845 (1988) [hereinafter Andrew, *Executory Contracts*]; Michael T. Andrew, *Executory Contracts Revisited: A Reply to Professor Westbrook*, 62 U. COLO. L. REV. 1 (1991) [hereinafter Andrew, *Reply to Westbrook*].

executory.<sup>93</sup> A slightly modified version of Countryman's chart follows:

<b>"Countryman Test" for Characterizing Contract Obligations</b>		
	Nondebtor's Obligation Performed	Nondebtor's Obligation Executory
Debtor's Obligation Performed	Fully Executed Contract	Asset of the Debtor
Debtor's Obligation Executory	Claim against the Debtor	Executory Contract

If the contract is fully performed on both sides, the contract is fully executed, and there is nothing for the law to do. Similarly, if the debtor has fully performed, the nondebtor simply owes an obligation to the debtor that can be enforced inside or outside of bankruptcy by the trustee or debtor-in-possession.<sup>94</sup> The contract right is an asset of the estate.<sup>95</sup>

93. Vern Countryman, *Executory Contracts in Bankruptcy: Part I*, 57 MINN. L. REV. 439 (1973) [hereinafter Countryman, *Part I*]; Vern Countryman, *Executory Contracts in Bankruptcy: Part II*, 58 MINN. L. REV. 479 (1974) [hereinafter Countryman, *Part II*].

94. Section 541(a) vests in the bankruptcy estate all of the debtor's "legal and equitable interest in property." 11 U.S.C. § 541. This includes the debtor's right to insist on performance of the contract. To make this clear, § 541(c) overrides nonassignment clauses that would otherwise prevent the transfer of such contractual rights to the estate. *Id.* § 541(c).

95. Both Westbrook and the National Bankruptcy Review Commission have noted that courts have been mystified by the significance of a determination that a contract is not "executory." Many courts have adopted the "functional approach" proposed by Westbrook in the article discussed in the text. Under the functional approach nothing turns on the determination of executoryness, except preserving for the debtor time postpetition to determine whether to perform. The National Bankruptcy Review Commission recommended doing away with the "executoryness" requirement entirely. NAT'L BANKR. REV. COMM'N, *BANKRUPTCY: THE NEXT TWENTY YEARS, FINAL REPORT* 454 (1997) [hereinafter COMMISSION REPORT]; see also Jay Lawrence Westbrook, *The Commission's Recommendations Concerning The Treatment of Bankruptcy Contracts*, 5 AM. BANKR. INST. L. REV. 463 (1997).

The legally complex categories are those where there is some obligation of the debtor (such as a privacy promise) that remains to be performed at the time of bankruptcy. Here, as with any claim against the debtor, whether for payment or performance, the non-debtor runs up against the debtor's insolvency, and bankruptcy's so-called "equality principal," which can be summed up as "similarly situated creditors should be treated equally."<sup>96</sup> As Westbrook put it:

The first concrete consequence of the equality principle is that the trustee can breach (reject) a contract profitably far more often than can other contract parties because the trustee pays only a fraction of contract damages rather than the full amount of the Other Party's breach loss. From that simple proposition flows most of the economic "magic" associated with bankruptcy contract doctrine.<sup>97</sup>

If the nondebtor has fully performed, as with a loan contract, or in most cases with a privacy promise, the obligation is treated as an unsecured prepetition claim under § 502 of the Code.<sup>98</sup> The consequence of being treated as an unsecured claim is that the value of the claim is paid out of the unencumbered assets of the estate,<sup>99</sup> if any exist, and then discharged.<sup>100</sup> Typically unsecured claimants receive only cents on the dollar. If claims for violation of Yahoo's privacy policy are treated as dischargeable unsecured claims, Yahoo's customers will be forced to rely on their pro-rata share of the unencumbered assets of the estate for their recovery.

If both the debtor and the nondebtor have obligations to perform, the treatment is, on its face, somewhat more complicated, but in the case of Yahoo's privacy promise, the outcome is the same.<sup>101</sup> When obligations remain on both sides, the contract is treated as an "executory contract" under § 365 of the Bankruptcy Code. Then the

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96. 11 U.S.C. §§ 726, 1122(a), 1322(a)(3).

97. Westbrook, *supra* note 56, at 246.

98. 11 U.S.C. § 502(g).

99. *Id.* § 502(a).

100. *Id.* § 524.

101. Andrew, *Reply to Westbrook*, *supra* note 92, at 8 ("But while unnecessary, rejection is also harmless: It does not make the contract obligation somehow vanish, and its 'breach' consequence does nothing more than create a claim. Thus, whether the contract is 'executory' or not, the result is the same: The non-debtor party has a claim.").

debtor is given the option to "assume" (perform) the contract, and retain the benefit of the nondebtor's performance, or to "reject" (breach) the contract.<sup>102</sup> If the contract is rejected, the claim that arises from the breach is, again, treated as a prepetition unsecured claim, notwithstanding that the breach may not have occurred until after the debtor filed for bankruptcy.<sup>103</sup> The nondebtor will receive payment in cents on the dollar.

These latter two categories (claim and executory contract) thus provide a stark demonstration of bankruptcy's effect on privacy policies if those policies are given liability-based protection. Breach by Yahoo of its privacy policy will be treated as a dischargeable claim. When the debtor's business fails, it may choose to sell personal information in its possession, and pay the resulting claim in bankruptcy dollars. To all outward appearance, bankruptcy gives the debtor the power to simply walk away from its contractual obligations. Westbrook notes, however, "[t]he key point here is that it is the discharge that costs all of [the unsecured creditors], ... the right to enforce their unsecured contract claims, not some exotic bankruptcy rule about 'executory' contracts."<sup>104</sup> Indeed, it may not be bankruptcy law at all that causes this problem. It is merely an illustration of what law and economics scholars call the "judgment proof" problem.<sup>105</sup> Liability-based entitlements are not particularly useful for enforcing duties against people or entities without assets.

Most of Yahoo's personal information will derive from one-time transactions. A customer visits the Yahoo website, and in return for the promise of confidentiality and the use of the website, discloses certain information. The information then goes into Yahoo's database, and the transaction is complete, except for the debtor's continuing obligation to keep the information confidential, and perhaps the debtor's continuing obligation to provide access to the website. Because all of the future (executory) obligations (and none of the benefits) under this contract run to the debtor, there is no business incentive for the debtor to honor the contract,<sup>106</sup> and

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102. 11 U.S.C. § 365(a).

103. *Id.* § 365(g).

104. Westbrook, *supra* note 56, at 277.

105. Shavell, *supra* note 10, at 56; *see also* LoPucki, *supra* note 10, at 1.

106. If the contract is executory, then this must be accomplished by rejection. If the contract is nonexecutory, rejection is not necessary. 11 U.S.C. § 365(a). Westbrook argues

because of the bankruptcy discount, the likely result is sale of data to the highest bidder. Even in the unusual cases where the customer still has obligations to perform and the contract is therefore "executory," the outcome is no different. The consequences of the debtor's decision not to perform will be treated as a prepetition claim,<sup>107</sup> and the application of the bankruptcy discount to the nonbankruptcy breach claim will create a strong incentive for the debtor to breach its privacy promise and sell a nondebtor's personal information.

In sum, if a privacy promise is treated solely as a promise, and the customer's personal information has value if sold, there is an overwhelming incentive for the debtor to breach the promise. On the one hand, this will allow the debtor to maximize the value of its assets. To the extent that the debtor's cache of personal information is valuable, this regime allows the debtor to realize that value for the benefit of its creditors. On the other hand, the liability-based regime will also have the unfortunate effect of defeating customer expectations.

This last harm is twofold. It affects the individual whose information is disclosed, and it affects society, in the form of two related "commons." First, there is what might be called the "e-commerce commons." The World Wide Web is still in the early stages of developing into a global marketplace. To the extent that consumer trust in e-commerce is depleted when companies fail and in the process disclose personal information, the result may be significant harm to cyberspace. Second, there is what might be called the "privacy commons" which can be viewed as a necessary precondition to democracy.<sup>108</sup> The Web is not just a space where

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forcefully that this distinction is meaningless:

[Executiveness] is a requirement with no basis in the Code. If bankruptcy contract problems can be fully understood without reference to that requirement, it is surplusage and has no effect except confusion and obfuscation. No bankruptcy policy is served by the requirement, and executiveness is not necessary to the operation of the well understood basic rules about treatment of bankruptcy contracts.

Westbrook, *supra* note 56 at 282. Under current law, however, the ritual of rejecting may be necessary to ensure that a creditor will not argue that the "breach" occurred postpetition, and that they are entitled to an administrative claim under the Code. See 11 U.S.C. § 503.

107. 11 U.S.C. § 385(g).

108. LAWRENCE LESSIG, *THE FUTURE OF IDEAS: THE FATE OF THE COMMONS IN A CONNECTED WORLD* (2001); Yochai Benkler, *Free as the Air To Common Use: First*

commerce happens. It is also a space where civil society exists, where public speech and private conduct occur to the benefit of society as a whole. Without appropriate protection of personal information, this function of the Web (and this aspect of civil society) may be sacrificed.<sup>109</sup>

## 2. *Property Rules—Specific Performance, License Law, and Secured Claims in Bankruptcy*

Because of the bankruptcy discharge, a liability-based regime is simple, but unprotective of privacy promises. By contrast, bankruptcy law seeks to leave property relatively undisturbed.<sup>110</sup> A property regime may therefore turn out to be more protective, if not overprotective of privacy promises.

### a. *Secured Claims in Bankruptcy*

If a creditor has an interest in the debtor's property that is enforceable against the bankruptcy trustee, that creditor is treated as a secured creditor under § 506 of the Bankruptcy Code.<sup>111</sup>

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*Amendment Constraints on Enclosure of the Public Domain*, 74 N.Y.U. L. REV. 354 (1999).

109. For an excellent discussion of the "privacy commons," see Paul M. Schwartz, *Privacy and Democracy in Cyberspace*, 52 VAND. L. REV. 1609, 1667 (1999) [hereinafter Schwartz, *Privacy in Cyberspace*] ("Privacy territories are also needed for personal data in cyberspace; multi-dimensional privacy norms must draw on workable standards capable of creating information preserves. Participants in cyberspace need access to public, quasi-public, and private spaces where they can engage in civic dialogue and the process of self-definition."). See also Paul M. Schwartz, *Beyond Lessig's Code For Internet Privacy: Cyberspace Filters, Privacy-Control, And Fair Information Practices*, 2000 WIS. L. REV. 743 [hereinafter Schwartz, *Lessig's Code*]; Paul M. Schwartz, *Internet Privacy and the State*, 32 CONN. L. REV. 815, 834 (2000) [hereinafter Schwartz, *Privacy and the State*] ("[T]he current privacy regime has a negative effect on the Internet's ability to contribute to democratic community in the United States.").

110. The effect of a bankruptcy discharge is to enjoin enforcement of a debt, not to displace property interests. 11 U.S.C. § 1141(d)(1)(A) ("Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan ... discharges the debtor from any debt that arose before the date of such confirmation ...."). Although the Trustee in Bankruptcy does have the power to avoid certain property interests, that power is much more limited. *Id.* § 550.

111. *Id.* § 506. Although the debtor is entitled to use property of the estate during the bankruptcy, *id.* § 363, and can sell non-cash collateral with court approval, *id.* §§ 363(e),(f), the holder of the property right is entitled to have the value of that claim protected during the course of the bankruptcy—except to the extent that the compensation is for the delay in



Because privacy policies are promissory in nature, however, it is not particularly easy to characterize privacy promises as embodying a property interest.<sup>112</sup> The usual view of personal information is that an individual has the absolute power not to disclose information, but that once the information is disclosed, no property interest remains.<sup>113</sup> Under current law, this is the likely result. However, to the extent that more protection of data is desirable, some judges might be willing to be creative, or Congress might pass legislation. There are two theories that might work under current law, or which might be adopted as a mechanism for propertization: (1) specific performance, and (2) license.

*b. Specific Performance in Bankruptcy*

As noted above, there is a reasonable likelihood that outside of bankruptcy, a court would find a privacy promise enforceable by specific performance. Damages are likely to be inadequate: the information is unique, and the harm is continuing. Outside of

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foreclosure occasioned by the stay. *United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assoc.*, 484 U.S. 365 (1988). As such, they may be entitled to adequate protection payments, 11 U.S.C. § 361, and may be able to obtain a lifting of the stay to foreclose. *Id.* §§ 362(d), 363(e). In short, the property right must be respected. It is somewhat difficult to give meaning to these concepts when a privacy policy is involved. Adequate protection is usually understood to protect the financial value of an asset, and the value of personal information is not principally monetary. Moreover, if the property interest exists at all, it is a right against disclosure (i.e., sale) of the information; it is difficult to conceive of a form of "adequate protection" that would permit the sale.

112. Privacy scholars are grappling their way toward various conceptions of fair information practices. As discussed in Part IV below, these fair information practices might at some point provide a framework for "adequate protection" of a nondebtor's rights in personal information, but that regime is not in place under current law. Moreover, this regime is not likely to develop so long as privacy policies are treated as purely contractual in nature.

113. This view of personal information turns on what Paul Schwartz described as the "data seclusion deception." Schwartz, *Privacy in Cyberspace*, *supra* note 109, at 1663. Schwartz writes:

The idea of privacy as data seclusion is easy to explain: unless the individual wishes to surrender her personal information, she is to be free to use her privacy right as a trump to keep it confidential or to subject its release to conditions that she alone wishes to set. The individual is to be at the center of shaping data anonymity. Yet, this right to keep data isolated quickly proves illusory because of the demands of the Information Age.

*Id.*

bankruptcy, a contract right that is enforceable by specific performance crosses the line from contract to property right.<sup>114</sup> The legal rights can be enforced by legal compulsion, not just damages. The status of specifically enforceable promises in bankruptcy, however, is less clear. Countryman stated the general principle that specific performance cannot be enforced against the estate.<sup>115</sup> Specific performance, he explains, would have the effect of preferring the contract claimant above other unsecured creditors.<sup>116</sup> Although this is descriptively accurate and good policy, Countryman never fully explains why this is true as a doctrinal matter. The result was a series of highly controversial executory contract cases that made it look as though § 365 conveyed an additional "avoiding" power on the trustee.<sup>117</sup>

According to Westbrook, Countryman missed a step. The general principle that specific performance is not available in bankruptcy, though true as a descriptive matter, actually requires a two-step analysis. Specific performance *does* create a property right under state law. That property interest, however, may be subject to avoidance under one of the trustee's avoiding powers.<sup>118</sup> The tortured reasoning in cases analyzing specific performance derives from a failure to understand the difference between a contract right and a

114. See Westbrook, *supra* note 56, at 247.

115. See *id.* at 255; Countryman, *Part I, supra* note 93, at 465, 471 n.121; see also Jay L. Westbrook, *The Coming Encounter: International Arbitration and Bankruptcy*, 67 MINN. L. REV. 595, 623-24 (1983).

116. See Westbrook, *supra* note 56, at 255-56.

117. See, e.g., *In re Richmond Metal Finishers, Inc.*, 34 B.R. 521 (Bankr. E.D. Va. 1983), *stay denied*, 36 B.R. 270 (Bankr. E.D. Va. 1984), *rev'd*, 38 B.R. 341 (Bankr. E.D. Va. 1984), *rev'd sub nom. Lubrizol Enters. v. Richmond Metal Finishers, Inc.*, 756 F.2d 1043 (4th Cir. 1985), *cert. denied sub nom. Lubrizol Enters. v. Canfield*, 475 U.S. 1057 (1986); *Burger King Corp. v. Rovine Corp. (In re Rovine Corp.)*, 5 B.R. 402, 404 (Bankr. W.D. Tenn. 1980), *later proceeding*, 6 B.R. 661 (Bankr. W.D. Tenn. 1980).

118. 11 U.S.C. §§ 544, 545, 547, 548, 549, 550 (2000); see also Andrew, *Reply to Westbrook, supra* note 92, at 17. Andrew explains:

Consistent with bankruptcy law's general deference to state-law rights in or to specific property, rejection of a contract does not terminate such rights that arise from rejected contracts. That is, rejection is not itself an avoiding power. Rights in property that arise from a contract may, however, be terminated by bankruptcy law's normal avoiding powers (citations omitted).

*Id.*

property right in a specific asset, or as Westbrook calls it, an "Interest in the Thing Itself" (ITI).<sup>119</sup>

The result was that courts tried to make § 365 do too much work.<sup>120</sup> Many contracts create rights against particular assets. As noted above, when a seller agrees to sell a book, she creates an entitlement in the buyer to that book. If the seller declines to deliver the book as promised, state law may protect the buyer's rights with a damage remedy (a liability rule), or, if the book is a unique first edition, may enforce that contract by specific performance (a property rule). To use Westbrook's terminology, if the buyer's right is enforceable by specific performance, the buyer has an ITI.

This, however, does not end the inquiry. If there is an ITI, that ITI cannot be avoided through rejection of the contract. The ITI may, however, be subject to avoidance under one of the trustee's other avoiding powers.<sup>121</sup> Most importantly, the transfer may be avoidable under the trustee's "strong-arm" power.<sup>122</sup> Under § 544 of the Bankruptcy Code, the trustee can avoid any conveyance of property that could have been avoided by a hypothetical lien creditor or bona fide purchaser of real estate at the moment of bankruptcy. For example, an unrecorded sale of land is enforceable by specific performance and creates an ITI. An unrecorded sale of land, however, can be avoided by a bona fide purchaser, and hence by the bankruptcy trustee. The ITI is therefore unenforceable in bankruptcy and there is no right to specific performance. Similarly, when personal property is involved, a purchaser who wishes to beat the bankruptcy trustee must either take possession or record a UCC financing statement with the Secretary of State.<sup>123</sup> Therefore, an executory contract to sell a particular book might be specifically

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119. Westbrook, *supra* note 56, at 245-46 ("The most important and pervasive exception to the equality principle throughout bankruptcy law is the enforcement of state-law interests in specific assets of the estate, what may loosely be called a 'property right' and what I call an 'Interest in the Thing Itself' (ITI).").

120. See, e.g., cases cited *supra* note 117.

121. 11 U.S.C. § 544 (2000) (strong arm), *id.* § 545 (statutory liens), *id.* § 547 (preferences), *id.* § 548 (fraudulent conveyances), *id.* § 549 (post petition transfers), *id.* § 550 (avoided transfers).

122. *Id.* § 544.

123. U.C.C. §§ 9-308(a), 317(a) (1950 & Supp. 2001).

enforceable, but if delivery is not complete or a filing has not been made, the interest would appear to be avoidable.<sup>124</sup>

In short, Westbrook advocates treating specifically performable promises as property rights, but he does not stop there. He then would ask: Is this property right enforceable against third parties? If the answer is no, then it should not be enforceable in bankruptcy. In each case, therefore, one must ask what state law requires to perfect this type of property interest. In most cases, answering this question will vindicate Countryman's general statement that specific performance will not lie against the estate. Westbrook's approach, however, properly focuses the inquiry on whether a particular property right should be enforced against other creditors of the estate."<sup>125</sup>

When privacy promises are involved, this is a particularly troublesome question. As Westbrook emphasizes, "The analysis becomes complex in these cases when nonbankruptcy law is unclear about the Other Party's right to an ITI."<sup>126</sup> Current law does not accord property status to personal information, treats privacy policies as promissory in nature, and gives few clues as to whether those rights should be enforceable against the estate.

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124. Filing in the Article 9 system only works to perfect a security interest. It does not generally work to perfect a sale. Sales of accounts, chattel paper, promissory notes, and payment intangibles are, however, recordable in the Article 9 system. If Article 9 does not govern the transaction, it is necessary to look to the nonuniform law of the state to determine how one can perfect one's property interest. See, e.g., *Bluxome St. Assocs. v. Fireman's Fund Ins. Co.*, 206 Cal. App. 3d 1149, 1154 (Cal. Ct. App. 1988) (discussing perfection of a lien on a legal malpractice cause of action under California law).

125. Westbrook, *supra* note 56. Michael Andrew reaches a similar result by a slightly different route. Under his approach, executory contracts are not binding upon the estate until assumed. According to Professor Andrew:

[T]he supposed "rule" that there is no specific performance in bankruptcy is actually just a consequence of the fact that the estate itself is not, absent assumption, bound by the debtor's contracts. Not only is there no right of specific performance of an unassumed contract against the estate, there is likewise no right to recover damages against the estate itself—i.e., administratively. The estate is simply not a party to the contract.

Andrew, *Executory Contracts*, *supra* note 92, at 920-21. As such, if a specifically enforceable promise is not assumed, it will not be binding on the estate. Andrew, *Reply to Westbrook*, *supra* note 92, at 28.

126. Westbrook, *supra* note 56, at 270.

*c. Adequate Protection and Sale Free and Clear*

Even if Yahoo's customer list is viewed as property subject to an encumbrance or secured claim, it may still be possible to override the privacy policy in bankruptcy. Under § 363 of the Bankruptcy Code, the debtor has the power to use and sell assets of the debtor both inside and outside of the ordinary course of business.<sup>127</sup> When the sale is outside the ordinary course of business, the debtor must obtain court approval under § 363(c), and if the asset is encumbered, under § 363(e), the holder of the property interest is entitled to adequate protection.<sup>128</sup> This may include a continuation of the lien on the property, in the hands of the purchaser,<sup>129</sup> but under § 363(f), the bankruptcy court also has the power to allow the debtor to sell property free and clear of liens under certain circumstances.<sup>130</sup> Such a sale is likely to be permissible only if applicable nonbankruptcy law permits such a sale free and clear of liens.<sup>131</sup> Here, the ill-formed nature of nonbankruptcy law makes the question impossible to answer with any confidence.

Thus, if personal information is treated as property held subject to an encumbrance, there are two undefined terms in the equation. First, what does it mean to "adequately protect" a website customer's interest in personal information under §§ 361 and 363(e),

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127. 11 U.S.C. § 363 (2000).

128. *Id.*

129. U.C.C. § 9-315(a) (1950 & Supp. 2000).

130. Section 363(f) provides:

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if-

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

11 U.S.C. § 363(f). A website visitor's interest in personal information, to the extent it exists, is not a lien, not in dispute, and likely to be enforceable by specific performance. As such only §§ 363(f)(1) and (2) are likely to provide a mechanism for selling personal information. Although the trustee could attempt to obtain consent, this solution is unlikely to be feasible.

131. *Gouveia v. Tazbir*, 37 F.3d 295, 299 (7th Cir. 1994).

and, second, to what extent does “applicable nonbankruptcy law” permit its sale free of such an interest under § 363(f)? In short, while the treatment of personal information appears to turn on the characterization of a privacy policy as creating a contract right or a property right, the remedial focus proves to be inadequate. Even if personal information is accorded the status of property, one cannot administer the property regime without defining the “form” of the underlying entitlement.

*d. Licenses in Bankruptcy*

A second approach is to consider the personal information conveyed to Yahoo as property subject to a limited license. Yahoo’s right to use the information is subject to the terms of the license. Where patents, trademarks, and copyrights are involved, a license is structured as a covenant not to sue the licensee for infringement of the licensor’s intellectual property right.<sup>132</sup> As such, if the debtor wanted to “use” the customer’s personal information, it would be necessary to “assume” or perform the contract pursuant to § 365 of the Bankruptcy Code. In other words, Yahoo would have to comply with the privacy policy. If the privacy policy provided that the information could not be disclosed, then the court would have to determine whether the provision was a valid restriction on alienation or an impermissible nonassignment clause under § 365(f).<sup>133</sup>

The problem with characterizing personal information as property conveyed subject to a license, however, is that, unlike intellectual property or other personal property, the underlying entitlement is not clearly defined, if it exists at all. Nonbankruptcy law does not confer an enforceable property right in personal information, and to the extent that it does, it is not clear by any means that it continues

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132. *Hilgraeve Corp. v. Symantec Corp.*, 265 F.3d 1336, 1346 (Fed. Cir. 2001) (stating that “licenses are considered as nothing more than a promise by the licensor not to sue the licensee”) (quoting *Jim Arnold Corp. v. Hydrotech Sys., Inc.*, 109 F.3d 1567, 1577 (Fed. Cir. 1997)).

133. 11 U.S.C. § 365(f) (2000). Indeed, under current law involving intellectual property licenses, it is unclear whether it is even permissible for a debtor to assume such a license. Compare *Everex Sys., Inc. v. Cadtrak Corp.* (*In re CFLC, Inc.*), 89 F.3d 673 (9th Cir. 1996), and *Perlman v. Catapult Entm’t, Inc.* (*In re Catapult Entm’t, Inc.*), 165 F.3d 747 (9th Cir. 1999), with *Institut Pasteur v. Cambridge Biotech Corp.*, 104 F.3d 489 (1st Cir. 1997).

once the information has been disclosed to third parties.<sup>134</sup> While license law may provide a handy conceptual framework for thinking about propertizing personal information, again, the difficult task becomes deciding what shape that right should take. This question, and the concept of a default license based on fair information practices, are taken up in more detail below.<sup>135</sup>

*e. Property ex machina—The FTC Act*

Max Headcold suddenly picks his head up off the table and says, "Enough about property rights that don't exist. What you're saying is that we can file for bankruptcy, breach the privacy policy, and pay damages in cents on the dollar. It sounds like we're different from Toysmart. Let's do it!!"

"Not so fast," you reply. Under current bankruptcy law, the most likely treatment of a privacy promise is as a contract-based right, subject to discharge. Nothing about the privacy policy is likely to entitle it to "property" status. Even though website customers are likely entitled to specific performance, specific performance does nothing to enhance their status in bankruptcy. The *Toysmart* case provides an object lesson. It was not, in the end, bankruptcy law that chilled the sale. Toysmart's reorganization consultants were probably right as a matter of bankruptcy law that the information could be sold notwithstanding the privacy policy. In the absence of nonbankruptcy law propertizing privacy promises, privacy policies seem destined to be treated as liability-based and subject to discharge. This analysis is likely what led Toysmart's consultants to advertise the debtor's customer lists as for sale.

The *Toysmart* result instead was driven by a sort of "property right *ex machina*" in the form of the FTC, asserting its authority under § 5 of the FTC Act<sup>136</sup> and the Children's Online Privacy

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134. Lawyers and doctors are a notable exception. Attorney-client privilege and doctor-patient privilege impose a confidentiality obligation on the recipient of the privileged information and give the client/patient the right to significantly control the manner in which the information will be used. Courts have noted, however, that contract and privilege are distinct interests in information. *See, e.g., McCormick v. England*, 494 S.E.2d 431, 434 (S.C. App. 1997).

135. *See infra* note 246 and accompanying text.

136. 15 U.S.C. § 45(a)(1) (2000).

Protection Act.<sup>137</sup> Section 5 of the FTC Act prohibits deceptive trade practices and empowers the FTC to enjoin such practices.<sup>138</sup> In the FTC's view, sale of the information in violation of the privacy policy was just such a "deceptive trade practice."<sup>139</sup> The FTC's suit led the bankruptcy court to enjoin the sale initially,<sup>140</sup> in effect propertizing the privacy policy. Such publicly-enforced rights help enforce privacy norms in bankruptcy, but, because there is no private right of action, enforcement is likely only in cases that are large enough to come to the attention of federal regulators.<sup>141</sup>

Curiously, however, even once the FTC was prepared to settle the case and allow sale under certain circumstances, the bankruptcy court declined to approve the settlement because it was "premature."<sup>142</sup> The bankruptcy judge was unwilling to relinquish the power to determine the meaning of the privacy policy and the terms of sale to the FTC. While it is unclear where the bankruptcy court's authority to do this comes from, other than the court's general equity power,<sup>143</sup> this emphasizes that the institutional locus for the determination of substantive entitlements to information privacy in e-commerce transactions remains up for grabs.

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137. *Id.* § 6503.

138. *Id.* § 45(a)(1),(2).

139. Complaint, *FTC v. Toysmart, LLC*, No. 80-11341 RGS (Mass. Dist. Ct. filed July 10, 2000), available at <http://www.techlawjournal.com/courts/toysmart/20000710.htm> (last visited Feb. 25, 2003). The right to be free of deceptive trade practices is an odd form of property. One result of Calabresi's focus on remedy rather than entitlement, is that many things that do not fit a traditional image of property are protected by a property rule. Thus, one's right to be protected from bodily harm is protected both by a liability rule (negligence) and a property rule (assault and battery). Similarly, the right not to be deceived in the marketplace is protected both by liability type rules (civil fraud) and by property-type rules (criminal fraud, FTC enforcement). This focus on remedy maps onto the treatment of rights in bankruptcy as well. Health and safety regulation is exempted from the automatic stay, 11 U.S.C. § 362(b), and the discharge injunction. *Id.* § 524.

140. See *supra* notes 65-67 and accompanying text.

141. Note that in many states there may be a private right of action under the state's law of deceptive trade practices. For a comparison of private and public enforcement schemes, see Janger, *supra* note 23.

142. See *Top Stories*, *supra* note 67.

143. 11 U.S.C. § 105(a).



*D. Inadequacy of Current Law: Privacy Expectations v. Reorganization Policy*

Under current contract law, treating privacy promises as liability-based obligations subject to discharge serves the bankruptcy goals of encouraging reorganization and preserving the value of assets for creditors. On the other hand, it has the disadvantage of defeating customer expectations of privacy, which are generated by the site's privacy policy. This bait and switch may have a second order effect of undercutting confidence in e-commerce and the Internet generally. By contrast, treating personal information as property has the unfortunate effect of destroying the value of an important asset of the debtor, when it might be possible to realize the value of that asset while still safeguarding reasonable consumer expectations.<sup>144</sup>

## II. PROPERTY AND LIABILITY V. CRYSTALS AND MUD

The distinction between property and liability that bedevils bankruptcy law mirrors a larger nonbankruptcy discussion among privacy scholars and law and economics scholars about the nature of property and liability rules. Privacy scholars have recognized this dichotomy and have become polarized by it. As discussed above, under current law privacy policies are contracts, protected by a damages-based remedial scheme and unprotected in bankruptcy.<sup>145</sup> Larry Lessig has suggested that treating personal information as property will allow the creation of a privacy marketplace and solve

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144. This uncertainty has given rise to a number of proposed legislative responses. For example, The Privacy Policy Enforcement Provision in the Bankruptcy Act of 2000 would have excluded personal information from the bankruptcy estate to the extent that a privacy policy prohibited disclosure. S. 2857, 106th Cong. § 2 (2000). House Bill 4814 would make sale of personal information a violation of § 5 of the FTC Act. H.R. 4814, 106th Cong. (2000). By comparison, The Consumer Privacy Protection Act would incorporate a number of the "Fair Information Practices," *see infra* Part IV.B, into any proposed sale of personal information. S. 2606, 106th Cong. § 2 (2000). In the last part of this Article, I discuss one such proposal for reform. Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 231 (2001) (Leahy Amendment). This proposed provision would prohibit any sale of personal information in violation of a privacy policy, but would permit such sale if the bankruptcy judge concluded that the sale gave appropriate protection to the data.

145. Schwartz, *Lessig's Code*, *supra* note 109, at 776 ("When evaluated within the Calabresi-Melamed framework, these standards sound in liability rather than property.").

the problem of cases like *Toysmart*.<sup>146</sup> On the other hand, privacy advocates like Marc Rotenberg of the Electronic Privacy Information Center and privacy scholars like Jessica Litman oppose propertization on the ground that it will lead to the commodification of something that is innately personal, advocating instead either a regulatory regime<sup>147</sup> or a tort-based liability regime.<sup>148</sup>

For the reasons discussed below, both Lessig's property-based solution and the regulation/tort-based solutions are insufficient taken alone. Lessig's focus on remedy is incomplete. Even if personal information is propertized, there are imperfections in the market for personal information that cast doubt on the ability of the marketplace to develop appropriate norms for data sharing.<sup>149</sup> The Toysmart privacy policy, which prohibits disclosure to outside parties,<sup>150</sup> is an anomaly in the commercial world. Most privacy

146. LESSIG, *supra* note 7, at 160.

147. Rotenberg, *supra* note 11, ¶ 5 ("In the use of the technique proposed by Lessig, it is a way to convert political rights into market commodities."). Rotenberg opposes propertization because he does not want to see a market in personal information:

Brandeis and Warren understood the problem with market-based approaches to privacy when they wrote the article on the right to privacy more than a century ago. They purposefully distinguished a privacy right from an intellectual property claim, noting that copyright typically protects an interest once publication occurs, privacy protects a right to simply not publish. They further noted that copyright preserves values that are based on marketplace determinations, whereas privacy protects values that are unique to each individual. Lessig's market-based model, which seeks to facilitate the transfer of control over privacy interests, is clearly at odds with this tradition.

*Id.* ¶ 93 (citations omitted).

148. Jessica Litman, *Information Privacy/Information Property*, 52 STAN. L. REV. 1283 (2000). Litman writes:

A tort law breach of trust approach does have significant advantages over a privacy-as-property model. It avoids the trap of alienability and the perverse incentives that a market in alienable personal data would create. Because it forgoes the privacy-rights-management market entirely, it is less likely to legitimize wholesale commercial exploitation of personal information. It would permit courts to give effect to subtle distinctions between consensual and invasive disclosure. Moreover, it has some symbolic value as a statement of societal expectations.

*Id.* at 1312 (citations omitted); see also William McGeveran, Note, *Programmed Privacy Promises: P3P and Web Privacy Law*, 76 N.Y.U. L. REV. 1812, 1843 (2001) (advocating a "promise-based" approach to information privacy).

149. See Walter W. Miller, Jr. & Maureen A. O'Rourke, *Bankruptcy Law v. Privacy Rights: Which Holds The Trump Card?*, 38 HOUS. L. REV. 777, 852 (2001) (calling for legislative market reform).

150. "In the *Toysmart* case, it is doubtful that anyone thought of the Toysmart privacy

policies, especially after *Toysmart*, do not give notice of how personal information will be protected, but rather explain obliquely how it may be shared.<sup>151</sup> At the same time, Rotenberg and Litman confuse remedy with right. Unless personal information is propertized, individuals will not even be able to enforce the protections for which they bargain.

This Section looks at the Yahoo hypo from a different angle and seeks to bridge the gap between Lessig and his critics by linking the property/liability literature to the rules/standards literature in a way that has not been done explicitly before.<sup>152</sup> The property/liability distinction divides privacy entitlements along the remedial axis—how a right will be protected. By contrast, the crystals/mud distinction divides the entitlement on the norm axis—what the entitlement is. The task in this Section is to develop an account of the interaction between right and remedy, between the articulation of substantive legal norms, and the manner in which they are enforced.<sup>153</sup> Just as bankruptcy law fails to deal adequately with

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policy as anything more than a promise not to reveal information." *Id.* at 816.

151. See Richard A. Beckmann, Comment, *Privacy Policies and Empty Promises: Closing The "Toysmart Loophole,"* 62 U. PITT. L. REV. 765, 788 (2001) ("Within two weeks of Judge Kenner's rejection of the Toysmart/FTC settlement, bellwether Internet retailer Amazon.com abruptly revised its privacy policy in an apparent direct response to the *Toysmart* case.").

152. As noted above, Richard Craswell has made the link implicitly in some of his work from the "contract" or "liability" side. Craswell, *supra* note 52, at 3-7, 27-28. Joseph Singer, in his focus on the expressive content of property law, also touches on the link between the substance of a property right and the manner in which it is enforced. JOSEPH WILLIAM SINGER, *ENTITLEMENT: THE PARADOXES OF PROPERTY* 112-17 (2000); JOSEPH WILLIAM SINGER, *THE EDGES OF THE FIELD: LESSONS ON THE OBLIGATIONS OF OWNERSHIP* 16, 20-25 (2000); see also Jane B. Baron, *The Expressive Transparency of Property*, 102 COLUM. L. REV. 208 (2002). Pamela Samuelson also has advocated a "trade secrets" regime that is similar to the muddy property approach advocated here. Samuelson, *supra* note 73, at 1143, 1151-52. She claims, however, that her approach does not turn on "propertizing" the right to information. *Id.* at 1128-29. If this is the case, then it will not provide any protection in bankruptcy.

153. Another note on terminology is important here. Some commentators distinguish clear from unclear rules by talking about rules and standards. See Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 612, 618-19 (1992); Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 1327 (2001); Duncan Kennedy, *From the Will Theory to the Principle of Private Autonomy: Lon Fuller's "Consideration and Form,"* 100 COLUM. L. REV. 94, 94-95 (2000); Duncan Kennedy, *Strategizing Strategic Behavior in Legal Interpretation*, 1996 UTAH L. REV. 785, 816. Others talk about crystalline and muddy rules. See Janger, *supra* note 37, at 560; Rose, *supra* note 8, at 578. At the same time, scholars who talk about property rules and liability rules use the term "rules" without regard to whether they are clear or unclear. Therefore, from time to time, I will use the terms "muddy rules" without intending an oxymoron.

privacy norms because the scope of the legal right and its status are ill-defined, the property/liability literature has never dealt adequately with the interaction between remedies and underlying substantive entitlements.

The solution to Lessig, Rotenberg, and Litman's conundrum lies in paying closer attention to the shape of the property right in personal information. That property right must be shaped in such a way that it will enhance the ability of courts—particularly bankruptcy courts—to articulate and enforce privacy norms for personal data transactions.

### *A. Property and Liability in a World of Inefficient Bargaining*

The first step in understanding Lessig's error is understanding what he means by "property" and how his focus on property as remedy serves to establish the primacy of the market in defining the scope of privacy entitlements. The second step is seeing how certain predictable market failures make such reliance on the market troubling in the personal privacy context.

#### *1. Property and Liability*

Lessig's view of property rests on the dichotomy articulated in the path-breaking article *Property Rules and Liability Rules: Two Views of the Cathedral*, by Guido Calabresi and A. Douglas Melamed.<sup>154</sup> In that article, Calabresi and Melamed seek to explain the difference between property and liability.<sup>155</sup> The difference lies along the remedial axis.<sup>156</sup> Property rules protect an entitlement with the

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154. Calabresi & Melamed, *supra* note 9, at 1093.

155. *Id.*

156. Recent work by Thomas Merrill and Henry Smith suggests that remedy is not the only characteristic that divides property and contract-based liability. The substantive definitions of property- and contract-based entitlements also manifest predictable differences. Thomas W. Merrill & Henry E. Smith, *The Property/Contract Interface*, 101 COLUM. L. REV. 773, 783 (2001) [hereinafter Merrill & Smith, *Property/Contract*]; see also Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1 (2000) (explaining the limited and standardized ways of owning property through information-cost theory). Merrill and Smith point out that property law tends to govern the relationship between large numbers of people and identifiable things, and normally take the form of a right to exclude. Merrill & Smith, *Property/Contract*, *supra*, at 789-90. Contract rights tend to regulate the behavioral obligations of identified and

threat of affirmative court order, and/or the sanction of the criminal law. If a thief were to steal some of Yachoo's inventory of ginseng or ginkgo biloba, the thief would be tried criminally and possibly sent to jail. On the civil side, the thief would be required to pay damages, but would also be subject to punitive damages to punish the theft. Liability rules protect an entitlement only with compensatory damages. If Yachoo were to breach a contract outside of bankruptcy, it would be required to pay "expectation damages" to put the nonbreaching party in as good a position as it would have been if the contract had been performed.<sup>157</sup> However, no "punishment" would be exacted.<sup>158</sup>

Carol Rose has characterized a property rule as allocating the "whole meatball" to the holder of the entitlement, and "zip" to everyone else.<sup>159</sup> Liability rules, by contrast, according to Carol Rose, Ian Ayres and Eric Talley, Louis Kaplow and Steven Shavell, and others allocate the right to one person, and the right to take and pay to others.<sup>160</sup> The Calabresian insight was that property rules facilitate bargaining by clarifying entitlements. By contrast, when bargaining is very difficult or impossible, liability rules provide an

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identifiable people to one another. *Id.* at 799-800. In their view, these characteristics cause a tendency toward bright-line rules and standardized property rights, whereas contractual arrangements tend to be more complex and highly customized. *Id.* at 778-79.

This prediction about property rules does not necessarily conflict with the theory of muddy property rights articulated in this Article. The claim that property relationships tend to evolve toward standardized forms is not inconsistent with the proposition that new forms of property, and property relationships where ownership is uncertain, will tend to be muddy until, on the one hand, the standard ownership norms are defined (i.e., a holder of someone else's information knows what they are entitled to do with it), or until the identity of the owner is defined (i.e., the website customer or the website).

Harold Demsetz explained this process of developing property relationships thus:

[P]roperty rights develop to internalize externalities when the gains of internalization become larger than the cost of internalization. Increased internalization, in the main, results from changes in economic values, changes which stem from the development of new technology and the opening of new markets, changes to which old property rights are poorly attuned.

1 HAROLD DEMSETZ, OWNERSHIP, CONTROL, AND THE FIRM: THE ORGANIZATION OF ECONOMIC ACTIVITY 107 (1988). For a more developed response to Smith and Merrill, see articles cited *supra* note 23.

157. 11 ARTHUR LINTON CORBIN, CORBIN ON CONTRACTS § 992 (Interim ed., reprint of chs. 55-60 in 1964 ed., vol. 5).

158. *Id.* § 1077.

159. Rose, *supra* note 25, at 2179.

160. *Id.* at 2176-79, 2190.

alternative means of allocating damages after a deprivation has occurred.<sup>161</sup>

Two polar examples are a negotiation over a sale of real estate and an automobile accident. When a buyer wishes to purchase Blackacre from a seller under a property rule, both the buyer and the seller know where the entitlement lies. This facilitates bargaining. The seller owns Blackacre and the buyer must offer a price that satisfies the seller in order to obtain any right to Blackacre. Otherwise, the buyer has "zip." When an automobile accident is involved, bargaining will not work. It is impossible for driver and pedestrian to negotiate a price before the accident. Tort liability seeks to repair the damage by financially approximating the harm.

## 2. Information-Forcing Liability Rules

The paradigm of the traffic accident becomes problematic when one recognizes that contract law also relies on liability-based remedies to enforce executory obligations. Ian Ayres and Eric Talley,<sup>162</sup> and Louis Kaplow and Steven Shavell<sup>163</sup> seek to answer this question by pointing out that property rules may not always facilitate bargaining towards efficient resource allocation. By allocating the whole entitlement to the owner of Blackacre, property rules create a "bilateral monopoly."<sup>164</sup> Buyer and seller have no choice but to bargain with each other.<sup>165</sup> If, as Calabresi and Melamed assume,<sup>166</sup> both parties have perfect information about the value of the property ascribed by each of the parties, this will not create obstacles to bargaining. When there is an information asymmetry, however, and one party knows more about the value of

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161. Calabresi & Melamed, *supra* note 9, at 1116.

162. Ian Ayres & Eric Talley, *Distinguishing Between Consensual and Nonconsensual Advantages of Liability Rules*, 105 YALE L.J. 235, 239-40 (1995) [hereinafter Ayres & Talley, *Advantages*]; Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate a Coasean Trade*, 104 YALE L.J. 1027, 1032-33 (1995) [hereinafter Ayres & Talley, *Solomonic Bargaining*].

163. Louis Kaplow & Steven Shavell, *Do Liability Rules Facilitate Bargaining? A Reply to Ayres and Talley*, 105 YALE L.J. 221, 223-24 (1995) [hereinafter Kaplow & Shavell, *Reply*]; Louis Kaplow & Steven Shavell, *Property Rules Versus Liability Rules* 109 HARV. L. REV. 713, 736 (1996).

164. GEORGE J. STIGLER, *THE THEORY OF PRICE* 207 (3d ed., 1966).

165. *Id.*

166. Calabresi & Melamed, *supra* note 9, at 1096-97.

the property than another, or, as is even more common, the parties know their own valuations but not the valuation ascribed to the property by the other party, then it is likely that the property rule coupled with the information asymmetry may cause the parties to miss what would otherwise be an efficient "Coasean" trade.<sup>167</sup> In such cases, liability rules may be more efficient. As Ayres and Talley put it:

Our core insight was that dividing an entitlement between two negotiators could cause more forthright and efficient bargaining. Essentially, we argued that these so-called Solomonic divisions tend to obscure the titular boundary between "buyer" and "seller" during bargaining and, in so doing, dampen the parties' strategic incentives to "shade up" or "shade down" their privately known valuations.<sup>168</sup>

Kaplow and Shavell make a similar point, but argue that the efficiency of liability rules turns on encouraging nonconsensual, but efficient transfers.<sup>169</sup>

To illustrate the Ayres and Talley insight with a gloss from Kaplow and Shavell, imagine that when Yachoo built its warehouse in an industrial park in New Jersey, it purchased a one acre lot. The lot borders a farm owned by Farmer Bob. Farmer Bob has had a series of bad harvests and wants to sell off a few acres to a real estate developer to help keep his family farm afloat. A real estate developer has offered to buy a piece of the farm adjoining Yachoo's warehouse. The only access to Bob's property suitable for heavy construction equipment, however, runs across a piece of Yachoo's property. Yachoo has no interest in that corner, and values the easement desired by Bob at \$20,000. By contrast, the farmer estimates that the easement adds \$50,000 to the value of his property. As

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167. Ayres & Talley, *Solomonic Bargaining*, *supra* note 162, at 1088.

168. Ayres & Talley, *Advantages*, *supra* note 162, at 237.

169. Kaplow & Shavell, *Reply*, *supra* note 163, at 230. Kaplow and Shavell explain: Under this alternative assumption, it can be shown that the advantage of the liability rule in terms of total welfare is much larger than in their example (\$2.25 rather than \$0.125), yet there are no successful bargains under the liability rule. Obviously, the (now greater) advantage of the liability rule cannot be attributed to the facilitation of bargaining, for there is none.

*Id.* (footnotes omitted).

such, Bob is the "higher value" user. A transfer of the property to Bob would be Kaldor-Hicks efficient, and a transfer at any price between \$20,000 and \$50,000, would be Pareto superior.<sup>170</sup>

Headcold knows nothing about the farmer's development plans, and the farmer has no idea whether Yachoo has plans for the parcel. Both, however, want to get as much for the easement as they can. The farmer decides to offer \$10,000 for the property. Headcold responds strategically. He lies, saying that the parcel is important to Yachoo's plans to expand its warehouse, and that he will not agree to sell the easement for less than \$70,000. With these two offers on the table, nothing will happen. Indeed, the gap appears so great that even a counteroffer is unlikely. Neither party is willing to deal at the other's stated price, even though there are prices at which both would be willing to trade. Strategic behavior and information problems cause the parties to miss an efficient trade.

Ayres and Talley explain that liability rules can help overcome this informational and strategic logjam. They argue that liability rules have the effect of forcing out private information about valuation.<sup>171</sup> Therefore if Yachoo's rights were protected by a liability rule, the ability of Farmer Bob to take the entitlement (i.e., trespass), and pay damages would reduce the bilateral monopoly problem. The holder of an entitlement under a liability rule (Yachoo) does not hold the whole meatball, but instead holds the meatball subject to an option. If a potential purchaser of an entitlement protected by a liability rule (Farmer Bob) states his willingness to "take and pay," he signals to the entitlement holder (Yachoo) that he is a high-value user of the entitlement. This has the effect of narrowing the settlement range, reducing the value of strategic behavior, and may facilitate a trade.

Kaplow and Shavell ask, "Why is it even necessary to force out information? Why doesn't Bob simply exercise his option?"<sup>172</sup> The answer is that Bob does not know the option price with certainty. If Bob takes, he must pay compensatory damages. The damages are determined based on the harm to Yachoo. Unless property is fungible, the amount of harm to Yachoo will be unknown, and

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170. For a discussion of the Kaldor-Hicks and Pareto definitions of efficiency, see JULES L. COLEMAN, *MARKETS, MORALS AND THE LAW* 84 (1988).

171. Ayers & Talley, *Solomonic Bargaining*, *supra* note 162, at 1061.

172. Kaplow & Shavell, *Reply*, *supra* note 163, at 232 & n.41.



determining damages will have costs. As a result, Bob faces a risk if he trespasses. Nonetheless, Bob's threat to trespass conveys to Yahoo the information that Bob is a higher valued user, and because Headcold and Yahoo do not know Bob's valuation, they face the risk of a nonconsensual taking.

In short, by permitting a nonconsensual taking and payment of damages, a liability rule has the effect of forcing out information about valuation and/or facilitating efficient transfers of the property.

### *3. Property Rules, Liability Rules, and Privacy Promises—The "Lemons Equilibrium"*

Unfortunately, applying the Calabresi and Melamed and Ayres and Talley insights to privacy promises does not help much. At first glance, there do not appear to be any huge obstacles to bargaining over transactions in personal information. Individuals who know what information they are selling should be able to price the transaction. Individuals who know what information they are buying should be able to set a price they are willing to pay. This apparent transparency supports applying a property rule. Furthermore, to the extent that transactions in personal information are viewed as "easy transactions," propertizing information seems a plausible solution.

It is Lessig's facile acceptance of transactions in personal information as "easy," that is his undoing. In his book, *Code and Other Laws of Cyberspace*, he proposes propertizing personal information and allowing technology to sort out the bargaining problems.<sup>173</sup> He points to the so-called "Protocol for Privacy Protection" or "P3P," which seeks to accomplish this through technology<sup>174</sup> by allowing website customers to program their privacy preferences in

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173. As Lessig states:

The law would be a kind of property right in privacy. Individuals must have both the ability to negotiate easily over privacy rights and the entitlement to privacy as a default. That is property's purpose: it says to those who want, you must negotiate before you can take. P3P is the architecture to facilitate that negotiation; the law is the rule that says negotiation must occur.

LESSIG, *supra* note 7, at 160. For a concise description of P3P, see McGeveran, *supra* note 148, at 1826-33.

174. Schwartz, *Lessig's Code*, *supra* note 109, at 744, 749.

advance, and then allowing the computer to negotiate the terms under which they will be granted access to websites.<sup>175</sup>

At present, however, the market for personal information is a much less friendly place than Lessig envisions, and "hard" privacy policies like Toysmart's and Yachoo's are not the norm. Indeed, they are increasingly the exception. As Paul Schwartz has pointed out, propertization of personal information alone is not a sufficient solution.<sup>176</sup> Neither will information-forcing liability rules remedy the problem. The imperfection in the market for personal information is not the result of an information logjam that obstructs trades. Instead, there are significant information asymmetries which make trading personal information easier than it should be. First, consumers do not have particularly good information about the type of data that is being gathered, or about how it is being used. Second, they do not have good information about the value of the data that they are disclosing, either to themselves or to the website. Third, consumer information transactions take the form of contracts of adhesion. The customers must give information, or they cannot buy goods on the website. In the absence of a functioning privacy market, consumers who wish to surf the web must accept the website's terms. Finally, surfers do not have good information about breach. Once personal information is "leaked," it is difficult to discover the source of the leak. Website visitors simply do not know what they are giving up, and giving personal information the status of "property" does not help solve this problem.

Some of these characteristics of the e-commerce privacy market may remedy themselves over time. The development of any such market solution is impeded, however, by the fact that, for the most part, individual websites lack an incentive to offer enhanced privacy protection. As Schwartz has noted, "[a] critical mass of sophisticated privacy consumers is not yet emerging."<sup>177</sup> Broadly speaking, the feasibility of negotiation under a property rule or a liability rule turns on the value of the item, the transparency of the transaction, and the availability of substitutes. The problem in the privacy marketplace is that the value of the item is relatively small, and the

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175. LESSIG, *supra* note 7, at 160-61.

176. Schwartz, *Lessig's Code*, *supra* note 109, at 745.

177. Schwartz, *Privacy and the State*, *supra* note 109, at 822.

transaction is not transparent. If Yahoo has bad privacy practices and cannot be relied on to keep a customer's brand of aromatherapy mouthwash confidential, the customer can simply switch to Drugstore.com. As I have noted, however, e-customers do not, by and large, understand what information is being gathered, how it is being used, and what it is worth.<sup>178</sup> Because the item's value is relatively small, customized negotiation is not efficient.<sup>179</sup> As a result, many web surfers give personal information without considering how it might be used.<sup>180</sup> Only the website owner knows the information has value. As a result, the information can, in the present environment, be gathered for free.

The current absence of a privacy market is stable, so long as the information asymmetry is maintained. This is what economists sometimes call a "Lemons Equilibrium."<sup>181</sup> As Richard Craswell

178. See Lawrence Lessig, *The Law of the Horse: What Cyberlaw Might Teach*, 113 HARV. L. REV. 501, 506, 509 (1999). Lessig describes the invisibility of cyberspace monitoring: "Data is collected, but without your knowledge. Thus you cannot ... choose whether you will participate in or consent to this surveillance.... Nothing reveals whether you are being watched, so there is no real basis upon which to consent." *Id.* at 505 (footnote omitted); see also Neil Weinstock Netanel, *Cyberspace Self-Governance: A Skeptical View from Liberal Democratic Theory*, 88 CAL. L. REV. 395, 476 (2000) ("[M]ost users are not even aware that the web sites they visit collect user information, and even if they are cognizant of that possibility, they have little conception of how personal data might be processed.").

179. Although websites by and large have posted privacy policies, it is not realistic to expect every customer who clicks through the site to read the policy, nor is it realistic to equate the use of the site as consent to the policy, whatever it might say. As Paul Schwartz has said, "privacy-consent neglects the actual conditions of choice regarding the processing of personal information, and permits notice to become an alibi for 'take-it-or-leave-it' data processing. Notice is emerging as the justification for a legal fiction of *implied consent* on the Internet." Schwartz, *Privacy and the State*, *supra* note 109, at 825. However, even privacy policies play an ambiguous role in the developing privacy market. Many privacy policies are not what they seem. Often they are disclosure consent policies rather than privacy protection policies.

180. Interestingly, the first reported instance of a dot-com offering to pay for personal information occurred as the result of a sale in bankruptcy. See Michelle Slatalla, *Online Shopper: Giving Up Privacy for a Bargain Price*, N.Y. TIMES, July 26, 2001, at G4 (explaining that when eToys went bankrupt, they sent an email to their customers suggesting that they shop at KBKids.com and noting that if the customer approved the transfer of information from eToys to KBKids.com, KBKids.com would offer them a \$5.00 coupon in return).

181. George Akerlof, Michael Spence, and Joseph E. Stiglitz won the 2001 Nobel Prize in Economics for their work on the effect of asymmetric information on markets. See Press Release, The 2001 Sveriges Riksbank (Bank of Sweden) Prize in Economic Sciences in Memory of Alfred Nobel (Oct. 10, 2001), available at <http://www.nobel.se/economics/laureates/2001/press.html> (last visited Feb. 12, 2003); see also George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970);

points out, such an equilibrium can develop, when buyers have good information about price, but bad information about nonprice terms like privacy protection:

[I]f sellers are competing with each other but buyers are not well-informed, the absence of better terms can result from a "lemons" equilibrium. Because terms that are good for buyers are generally more expensive for sellers, any seller that offers better terms will charge a higher price to make the same level of profits she could make by offering less favorable terms at a lower price. *However, if most buyers have good information about prices but only poor information about nonprice terms, they may not notice an improvement in nonprice terms, while they will definitely notice the higher price.* As a result, many buyers may stop purchasing from this seller. If the number of buyers who stop purchasing is sufficiently large, the seller will end up losing money as a result of her decision to offer the more favorable terms at a higher price. *In that case, no seller has an incentive to offer the more favorable terms, and the result is an equilibrium in which only bad contract terms (or "lemons") can be obtained.*<sup>182</sup>

To make matters worse, improving the quality of notice may not be a solution. The most recent development in the privacy market is the widespread mailing of privacy notices mandated by Gramm-

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Michael Rothschild & Joseph Stiglitz, *Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information*, 90 Q.J. ECON. 488, 492-93 (1976); Joseph Stiglitz, *Equilibrium in Product Markets with Imperfect Information*, 69 AM. ECON. REV. 339-45 (1979); Michael Spence, *Consumer Misperceptions, Product Failure and Producer Liability*, 44 REV. ECON. STUD. 561 (1977).

182. Craswell, *Property Rules*, *supra* note 52, at 49 (emphasis added). Steve Ware argues that this is not harmful if the "lemons" equilibrium occurs in an otherwise competitive market. Ware, *supra* note 34, at 212-13 n.95. Under his view, if websites are able to make money by selling personal information, this will allow them to sell goods on the website at a lower price. *Id.* Because all sellers will be selling both goods and information, the competition will eliminate the surplus, and the consumer will, in effect, pay the lower price for the product, without privacy, than he/she would have paid for the product with privacy. *Id.* This argument, however, makes a heroic empirical assumption that the value of personal information to marketers (i.e., what the marketers would pay) is the same as the amount that website customers would charge if they knew what information they were giving up. In other words, consumers might prefer to pay more in order to get privacy than the marketers benefit from having the information. There is no way to know, however, because the alternative transaction is not available.

Leach-Bailey.<sup>183</sup> To the extent that such policies have had any effect, it appears to be to increase the amount of mail, perceived as “junk” that consumers throw away unread.<sup>184</sup>

Ayres and Talley point out that liability rules may work better when there is imperfect information about valuation.<sup>185</sup> Information problems and adhesion problems thus counsel a liability rule,<sup>186</sup> but the information asymmetry present in the privacy market is not of the type that would be remedied by Ayres and Talley’s liability-based regime, which assumes that information problems obstruct efficient transactions rather than facilitate inefficient ones.

This is the first place in the analysis where the inadequacy of Lessig’s remedial focus becomes apparent. The information that is missing is not principally information about the value of personal information to websites, although that is certainly part of it. Also missing is information about behavior: what data is being gathered; how that information is being used; with whom it is being shared. With the exception of a few bankruptcy sophisticates, who understand that all commercial behavior involves assessments of credit risk, few website customers are likely to realize that the website’s privacy policy may be worthless if the website goes bankrupt. Property rule or liability rule, the result is the same. Customers give their information away for free. When these imperfections in the privacy market are identified, they cast doubt upon the market itself as a mechanism for generating the price and terms of personal data sharing relationships.

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183. See Janger & Schwartz, *supra* note 34.

184. Press Release, American Bankers Assoc., ABA Survey Shows Nearly One Out of Three Consumers Read Their Bank’s Privacy Notices (June 15, 2001), available at <http://www.aba.com/Press+Room/bankfee060701.htm> (last visited Feb. 25, 2003); Mark Hochhauser, *Lost in the Fine Print: Readability of Financial Privacy Notices* (July 2001); at <http://www.privacyrights.org/ar/GLB-Reading.htm> (last visited Feb. 25, 2003).

185. Ayres & Talley, *Solomonic Bargaining*, *supra* note 162, at 1030 (“[D]ivided entitlements can facilitate trade by inducing claim holders to reveal more information than they would under an undivided entitlement regime. Owners of divided, or ‘Solomonic,’ entitlements must bargain more forthrightly than owners of undivided entitlements, because the entitlement division obscures the titular boundary between ‘buyer’ and ‘seller.’”).

186. *Id.*

*B. The Lemons Equilibrium, the Coase Theorem, and the Incoherence of the Property/Liability Distinction*

The incoherence of the property/liability analysis in the information privacy context exposes an important deficiency in the property/liability literature as a whole. The Calabresian architecture ignores the shape of the underlying entitlement.<sup>187</sup> What private and public behavioral norms are being guarded by the substantive legal or contractual rule? This focus on remedy relies on the idea, promulgated by Ronald Coase, that in a world without transaction costs, the underlying allocation of rights is irrelevant, because parties will be able to contract their way to an efficient allocation of resources.<sup>188</sup> In a world of Coasean bargains, the goal of the law is to construct a remedial scheme that facilitates efficient allocations of rights.<sup>189</sup> Thus property rules are appropriate when bargaining is easy, but liability rules are necessary to substitute for (or facilitate) bargaining when there are information asymmetries or other obstacles.<sup>190</sup>

Because of the existence of a lemons equilibrium, however, bargaining over information entitlements is not likely to lead to efficient outcomes. For many transactions, remedying the information asymmetry or engaging in particularized negotiation may not be efficient, and use of a liability rule will not force out the missing information. The goal of any privacy regime should be to determine how to remedy the information asymmetry when possible, and to the extent that it is not possible, a privacy regime should provide efficient off-the-shelf terms.<sup>191</sup> Coasean bargaining, however, is not likely to be a source of efficient substantive entitlements.

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187. Ayres and Talley do recognize that uncertainty about entitlements is another way of "dividing" them, and they include an analysis of "probabilistic" entitlements in their discussion. *Id.* at 1073-74. However, they miss the fundamental distinction between "right" and "remedy" and how it alters the shape of negotiations.

188. There is reason to believe that Coase himself, unlike many of his followers, did not think that his assumptions had anything to do with the real world of contracts. Professor Paul Shupack at the Benjamin Cardozo School of Law tells of a colloquium he attended at the University of Chicago, where Coase castigated his colleagues stating that the point of the Coase theorem was that one had to study transaction costs rather than assume them away.

189. Coase, *supra* note 28, at 2-15.

190. *Id.*

191. The next Section addresses whether these terms should be mandatory, sticky, or waivable, and whether they should be property- or liability-based.

*C. Defining Entitlements—Crystals, Mud, and Institutional Choice*

The preceding discussion demonstrates that the architecture of the cathedral focuses on remedy and ignores substantive legal norms. The indeterminacy of the property/liability discussion turns on the fact that the shape of the underlying entitlement with regard to personal information is ill-formed and cannot be generated through negotiation. There are not yet well-formed substantive defaults for the privacy norms associated with e-commerce transactions. This willingness of Calabresi and Melamed to ignore substantive entitlements flows from the Coasean insight that, in a world of free bargaining, and in the absence of transaction costs, any initial allocation of entitlements after a series of trades will yield an efficient allocation of resources.<sup>192</sup> In a Coasean world, property rules are king and the shape of substantive entitlements can be determined by contract.<sup>193</sup>

When bargaining cannot be relied on to shape entitlements, however, there must be another source of substantive rights.<sup>194</sup> If

192. Coase, *supra* note 28, at 2-15.

193. Not all analyses of property and liability rules ignore the link with substantive entitlements. Craswell, for example, explains:

First, the law must develop some definition of "proper" consent. Second, in those cases lacking proper consent, courts must decide whether to protect Y with a property rule or a liability rule. Third, in those cases where Y is protected with a liability rule, there must be some criteria by which the court can decide what obligation would be most "reasonable."

Craswell, *Property Rules*, *supra* note 52, at 6.

Craswell, however, seeks to sidestep the question of nonconsent based norms. Indeed, when forced to talk about substantive rules, he notes:

The principle of free contract is by now so widely accepted that most modern observers would regard almost any term adopted with each party's full consent as just. As a result, when modern observers are forced to select contract terms on behalf of parties who are unable to consent, it is difficult to find any substantive criteria to fall back upon other than criteria based on the parties' own preferences, either actual or ideal.

*Id.* at 27.

194. The Calabresian answer to this question is also inadequate. Calabresi and Melamed would say that the inability to bargain counsels a liability rule. Calabresi & Melamed, *supra* note 9, at 1106-07. Allow the deprivation, but impose damages. *Id.* As Carol Rose has noted, however, Calabresi had certain real world examples lurking in the shadows when he formulated his scheme. Rose, *supra* note 25, at 2176 ("In spite of *Boomer's* quite visible

substantive rights are not derived from meaningful consent, they must come from somewhere else:<sup>195</sup> from legislation, from regulation, or from judicial decision. When privacy promises are involved, there is no universally accepted set of legal norms that can form the basis for liability or property rights.<sup>196</sup> Where should such norms be generated, and what legal status should they be given? Because the market cannot be relied on to generate efficient substantive entitlements, courts and legislatures will have to develop these entitlements.

In this Section, I will argue that muddy rules provide an alternative device for dividing entitlements that may help to protect and shape behavioral norms where contracting is likely to fail. *Unlike liability rules, which divide entitlements based on remedy and force out valuation related information, muddy rules divide the substantive entitlement itself, and force out information related to the contested norm.* The choice of a muddy rule has implications both for the choice of institutional decision maker and for the efficiency of decision making. Once I have described the impact of muddy rules,

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appearance in *The Cathedral*, a rather different example lurks in the shadows—something I will call a ‘shadow example’—that actually drives the analysis.”). For Calabresi and Melamed, the shadow example was tort law, or the law of accidents. *Id.* The duties were understood to derive from the common law of torts informed by the Hand Rule. Private ordering gave way silently, at least in part, to noncontractual legal norms.

195. See Janger & Schwartz, *supra* note 34. These substantive entitlements may also be referred to as contractual defaults. *Id.* Default terms are implied in contracts where the parties have not fully specified their agreements. The defaults may seek to approximate a hypothetical agreement, or they may seek to encourage certain behavioral norms. *Id.*; see also Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591 (1999); Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729 (1992); Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 89 (1989) (“Few academics have gone beyond one-sentence theories stipulating that default terms should be set at what the parties would have wanted.”). Such defaults may be easily waivable, or they may be sticky. When they become “mandatory,” they leave the realm of contract, except to the extent that they become implied-by-law terms of the contractual relationship.

196. As I will discuss later, fair information practices (FIPs) are emerging as a common framework for formulating these rights. Janger & Schwartz, *supra* note 34; Schwartz, *Privacy in Cyberspace*, *supra* note 109, at 1614. For a description of early proposals regarding fair information practices, see DAVID FLAHERTY, *PROTECTING PRIVACY IN SURVEILLANCE SOCIETIES* 306-10 (1989). For a more recent governmental discussion of a somewhat different set of fair information practices, see FTC PRIVACY ONLINE: A REPORT TO CONGRESS 7-12 (1998). Even if one accepts FIPs as a framework, however, their application is necessarily context specific.



I will attempt to demonstrate that the literature on privacy, and the rules/standards literature, suffer from their own incoherence because of a failure to consider the interaction between the definition of a right and its remedy. The salutary effects of muddy rules are most evident when the muddy rule is linked to a property rule, and the effects of muddy rules are somewhat unpredictable when linked to a liability rule.

### *1. Institutional Choice and Institutional Competence*

Legislatures generate rules by passing statutes. Regulatory agencies create laws by promulgating rules and issuing opinions in agency adjudications. Courts generate legal rules by issuing opinions. Each of these lawmaking institutions has different advantages and disadvantages.<sup>197</sup>

Courts can get a good look at the parties and can analyze a particular transaction, but they may not be able to view the broad sweep of all similar transactions or behavior or see how a particular rule or ruling might operate in other, perhaps more common, situations. Courts also have the ability to adapt by looking at particular cases, distinguishing them from earlier cases, and articulating the basis for distinction.<sup>198</sup> Finally, courts lack a broad independent basis for the legitimacy of their actions.<sup>199</sup> They must rely on the Constitution, statutes, regulations, or principles of the common law to frame their decisions.<sup>200</sup>

Legislatures, by contrast, are elected and have a legitimate basis for legislative authority. They also have the ability to gather facts, and take a broader policy-based view of a particular problem. Legislators are generalists, however, and may lack both the ability to see how these principles will operate in particular cases, and the expertise to know about the details of the particular area. Finally, legislation is inflexible and often difficult to amend.<sup>201</sup> As such,

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197. See generally NEIL KOMESAR, *IMPERFECT ALTERNATIVES* (1994).

198. In this regard, common law rulemaking has a temporal component that legislation lacks. Courts interpreting statutes have information at their disposal that the enacting legislature lacked. See *infra* text accompanying notes 222-23.

199. THE FEDERALIST NO. 78 (Alexander Hamilton).

200. *Id.*

201. See Edward J. Janger, *The Locus of Lawmaking: Uniform State Law, Bankruptcy Law, and Bankruptcy Reform*, 74 AM. BANKR. L.J. 97, 111-12 (2000) (discussing the problems

unlike courts, which can reshape rules on the fly, legislative rules tend to lock-in, even after the underlying conditions have changed.

Agencies are a hybrid. When rulemaking, they have particularized expertise that both courts and legislatures lack, but they lack the legitimacy of legislatures and the independence of courts. When adjudicating, administrative law judges function like courts, except that the administrative law judge may have particular expertise regarding cases within the agency's jurisdiction.

The legal norms generated by these processes can take the form of mandatory rules, which become implied terms in all contracts, or default rules, which govern unless the parties agree otherwise. In either case, the rules chosen will apply to the parties through the interaction of courts and the marketplace. Disputes either will be resolved through a legal decision or through an agreement hammered out in the shadow of the legal norm. There are, therefore, two institutional decisions to make. First, which institution will generate the substantive entitlements—legislature, courts, or the market? Second, which institution will resolve disputes—courts, including agency based adjudication, or the marketplace? These two questions are interdependent. How a rule is drafted will affect which institution makes the decision in each individual case. Which institution decides individual cases will affect the ability of the other institutions to craft rules.

## *2. Crystals, Mud, and Institutional Choice: Dividing Entitlements Along the Norm Axis*

A partial answer to these questions of institutional competence lies in the choice between crystals and mud.<sup>202</sup> How entitlements are structured influences where disputes will be resolved and, therefore, which institutions will interpret and shape the scope of the entitlements. As I stated earlier, crystals and mud are the key determinants of institutional choice. The rules/standards literature recognizes that, in general, mud does not facilitate transactions; it encourages disputes. When parties are uncertain about who holds

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met by Congress during its effort to pass the Bankruptcy Reform Bill).

202. As discussed below, however, this choice must be made with close attention to the status of the right as a property- or liability-based entitlement. See *infra* text accompanying notes 214-18.

an entitlement or whether certain behavior is permitted, they are likely to differ over the relative probabilities of a particular judicial outcome. The dispute may have to be resolved authoritatively after litigation. Muddy standards, therefore, increase the number of disputes, and increase the likelihood that a particular dispute will be resolved by a court. If judicial decision making is desired,<sup>203</sup> then a muddy standard will place the judge front and center. Muddy standards and crystalline rules can be created both by courts and by legislatures. Courts that distrust the marketplace may choose mud. By contrast, legislators that distrust courts can maintain control by enacting a crystalline prohibition, or turn the decision over to the marketplace by enacting a crystalline safe harbor.

As I have discussed elsewhere,<sup>204</sup> the common wisdom is that, other things being equal, a hard-edged rule is preferable to a muddy standard.<sup>205</sup> If parties can agree without judicial intervention, litigation costs are saved, court time is saved, and transactions are facilitated.<sup>206</sup> Muddy standards, however, have a number of underappreciated benefits which turn on the fact that disputes in the shadow of judicial decision making are not always a bad thing. In particular, muddy standards may be more effective at enforcing norms, at the behavioral level, than crystalline rules.<sup>207</sup> As Carol Rose eloquently states:

From this perspective, as indeed the more sophisticated economic analyses tell us, crystalline rules seem less the king of the efficiency mountain than we may normally assume. One can argue that elaborate ex post allocations of responsibilities might be efficient too, even if they make people's entitlements fuzzier ex ante. The very knowledge that one cannot gull someone else,

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203. This can be case by case judicial decision making or judicial norm generation.

204. See Edward J. Janger, *Muddy Rules for Securitizations*, 7 FORDHAM J. CORP. & FIN. L. 301, 313-14 (2002).

205. Rules have a number of advantages: they are predictable; violations are easy to identify; it is easy to bring behavior into compliance; and it is easier to negotiate around them because they are well-defined.

206. Crystalline rules have a number of disadvantages; they may be over- or underinclusive, or they may lead to undercompliance because of incomplete enforcement. See generally Keith N. Hylton, *The Influence of Litigation Costs on Deterrence Under Strict Liability and Under Negligence*, 10 INT'L L. REV. & ECON. 161, 163-64 (1990) (arguing that strict liability schemes lead to underdeterrence).

207. See Janger, *supra* note 37, at 565; Rose, *supra* note 8, at 600.

and get away with it, makes it less likely that anyone will dissipate time and effort in trying to find the gullible.<sup>208</sup>

If their behavior is close to the regulated line, muddy rules force parties to avert to the possibility of judicial scrutiny. For example, at the negotiation stage, a muddy rule about fraud may encourage parties to disclose information in order to reduce the likelihood that failure to disclose will later be viewed as fraudulent.

### *3. Muddy Rules and Norm-Related Information-Forcing*

To put it another way, just as entitlements can be divided by substituting liability for property, they can be divided by substituting mud for crystals. Liability rules divide entitlements by allowing nonconsensual takings,<sup>209</sup> muddy rules make it less clear where an entitlement lies, and therefore, increase the likelihood of disputes. The difference between these two methods of dividing entitlements, however, is as crucial as the similarity. Dividing entitlements on the remedial axis, based on the status of the entitlement, generates information about valuation, and/or reduces the extent to which differences of opinion about valuation will serve as an obstacle to efficient resource allocation. Liability rules encourage efficient transactions and efficient asset transfers by narrowing the gap in those valuations and by permitting non-consensual takings.<sup>210</sup> *By contrast, dividing entitlements on the normative axis, using a muddy form of entitlement, will force out norm-related information, and influence norm-related behavior through the threat of judicial decision making.*

The manner in which muddy rules force out norm-related information and affect behavior is hard to reduce to mathematical precision. Perhaps it is better to explain the dynamic with another example. Imagine that in a business-to-business transaction Yahoo obtains some confidential, but unpatented, business process information from one of its software manufacturers, BizPro. After entering into the arrangement, Yahoo starts another line of business through an affiliated company. The business process

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208. Rose, *supra* note 8, at 600.

209. See *supra* text accompanying note 169.

210. See *supra* text accompanying notes 167-72.

information obtained from BizPro would be useful to the affiliate. Yahoo promised BizPro that it would not disclose this information, but believes that a disclosure to an affiliate is within the scope of the original agreement. Yahoo is worried, however, that BizPro might disagree. Yahoo anticipates a dispute about the scope of the confidentiality agreement, and must decide either to disclose its behavior to BizPro and negotiate a resolution, or to use the information now and ask questions later. The agreement is silent about information transfers to affiliates. Therefore, for these purposes, Yahoo's confidentiality obligations are muddy.

A muddy standard regarding disclosure to affiliates would operate differently from a crystalline rule prohibiting such disclosure. A crystalline prohibition would yield one of two effects: either no transaction and no disclosure would occur, or Yahoo would approach BizPro and ask for permission (or threaten) to disclose its information. Here, the discussion would focus solely on valuation. How much will Yahoo have to pay BizPro for permission to disclose?

By contrast, if Yahoo's nondisclosure obligation is silent or muddy with regard to disclosure to affiliates, the conversation will look very different. Instead, Yahoo will have an incentive to clarify its right to disclose. If Yahoo signals its intention to disclose the information, the discussion with BizPro will not initially focus on price, but rather on whether Yahoo is *entitled* to disclose the information to its affiliate. In other words, is the affiliate's use of the information within the scope of the original terms of the contract or not? The discussion will focus on the norms of the data-sharing relationship. Why was the information given? How was it to be used, and by whom? How will the information be used by the affiliate? Although the discussion may ultimately turn to price, the initial discussion will be about the shape of the underlying entitlement.<sup>211</sup>

A muddy standard, like a liability rule, therefore, has an information-forcing effect, but they each force out different kinds of information. The information forced out by a muddy standard focuses on norm-related behavior, rather than on information about valuation.

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211. See STEPHEN J. WARE, *ALTERNATIVE DISPUTE RESOLUTION* § 3.20, at 154-58 (2001).

*D. A Typology of Entitlements*

Just as the property/liability discussion assumes crystalline entitlements and becomes incoherent when the shape of the underlying entitlement is unclear, so the crystals and mud conversation assumes that entitlements are protected as property. When the entitlement is protected by a liability rule instead, the information-forcing effect of mud may be severely diluted. The crystals and mud literature assumes only two options: judicial decision or consensual bargain in the shadow of a judicial decision. If the entitlement is protected by a liability rule, however, there is a third option. Liability rules introduce the possibility for non-consensual takings; the nonholder can simply elect to violate the entitlement and pay damages.<sup>212</sup> This is true whether the liability rule is crystalline or muddy, and the choice of a liability rule will have a significant impact on the information-forcing effects of that rule.

In other words, a particular transaction can be governed by a crystalline liability rule, a crystalline property right, a muddy liability rule, or a muddy property right, with each one having its own respective advantages and disadvantages. In each case, the more crystalline or property-like the entitlement, the more it can be said that the entitlement holder has the complete entitlement or "whole meatball." Alternatively, the more muddy or liability-like the entitlement, the more the entitlement is shared by the respective entitlement holders. The key point, however, is that "liability" and "mud" have fundamentally different effects. In order to see the differences, it is useful to show the typology of entitlements graphically.

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212. See *supra* text accompanying note 167-72.

Typology of Entitlements			
		Remedial Axis	
		Property	Liability
Norm Axis	Crystal	Nonholder (Nothing), Holder (Complete Entitlement)	Nonholder (Option), Holder (Entitlement Subject to Option)
	Mud	Nonholder (Possible Entitlement), Holder (Complete Entitlement Subject to Possible Entitlement)	Nonholder (Option and Possible Entitlement), Holder (Entitlement Subject to Option and Possible Entitlement)

The top two boxes of the table, crystalline property rules and crystalline liability rules, do not add anything to the property/liability discussion. The property/liability literature views entitlements as exogenous and, in effect, assumes crystals. The lower two boxes are more interesting. Muddy entitlements have the effect of dividing an otherwise complete property right into a property right subject to a claim or an easement. Muddy entitlements have the effect of dividing otherwise clear liability into liability that cannot be valued with certainty, short of litigation; this is not because the damages are difficult to calculate, but because the entitlement itself is uncertain.<sup>213</sup>

### *1. Muddy Property*

Mud may have different effects, therefore, depending on whether the entitlement is protected by a property right or by a liability

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213. In other words, the nonholder can still take and pay the full amount of damages, but there is a possibility that he may pay too much because liability itself is uncertain.

regime. If the right is property-based, then each possible holder of the right has a veto on every other party's use of the property. If the parties cannot resolve their dispute consensually, the suit will have to go to trial and the winner will get the complete entitlement. The effect of a muddy property rule is to force judicial resolution of the dispute. A second effect of a muddy property rule, however, is to deter transactions at the margin, because of the costs associated with litigation and the risk of judicial scrutiny. This deterrent effect will be beneficial, if the marginal behavior deterred violates the norm at stake, or if the benefits of deterrence exceed the costs of over and underdeterrence.

The process of resolving a dispute under a muddy property rule may be costly, but it will also generate a significant amount of information about norm-related behavior. In some cases, the presence of a muddy rule will encourage disclosure of information up front. In other cases, the disclosure will occur during discovery or at trial. Either way, the information that will determine who wins the lawsuit will not be purely, or even principally, related to the value of the assets at stake; it will relate to the norms protected by the muddy rule.

One relevant example of information disclosed as a result of a muddy property-like rule arises in the data privacy context. The aftermath of the *Toysmart* case and activity of the FTC in this area has made companies skittish about transferring data without customer consent. Indeed, the first reported instance of a dot-com offering to pay for personal information occurred as the result of a sale in bankruptcy.<sup>214</sup> When eToys went bankrupt, they sent an email to their customers suggesting that they shop at KBKids.com. If the customer approved the transfer of information from eToys to KBKids.com, KBKids.com offered them a \$5.00 coupon in return.<sup>215</sup> The muddy bankruptcy regime, therefore, forced eToys to disclose the intended transfer of private information and obtain consent.<sup>216</sup>

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214. See Slatalla, *supra* note 180.

215. *Id.*

216. Under current law, both the property-like protection of privacy entitlements and the fuzziness of that entitlement derive from the FTC's prosecutorial discretion. See *supra* text accompanying notes 136-41. This has been helpful, for the reasons described in the text, but it is also problematic in that the FTC's influence is conditioned on prosecutorial discretion. A true muddy property right would focus the norm-based discussions on the parties to the transaction, rather than on a government agency, and it would influence all transactions, not



On the other hand, *Toysmart* itself provides an example of how a muddy property right might go awry. When every website customer is given the right to prevent the sale of a valuable database, and there is no collective mechanism for resolving the dispute, the result can be what Michael Heller has termed an “anticommons,” where multiple rights of exclusion lead to the underuse of an asset.<sup>217</sup> As will be discussed below, the collective procedures of bankruptcy law provide a way to gain the benefits of muddy property while avoiding the “anticommons” problem.

## 2. Muddy Liability

The information-forcing effect of muddy liability is less clear than the information-forcing effect of muddy property. A muddy liability rule increases the probability of a nonconsensual taking, and hence, a dispute. Instead of a “take and pay” regime, muddy liability creates a “take and pay if you lose” regime. Whether muddy liability increases the likelihood of a judicial decision and/or disclosure of norm-related information or simply increases the likelihood of a nonconsensual taking will turn on the relationship between the costs of litigation, the value of the right, whether the principal uncertainty is norm-based or valuation-based, and who holds the burden of litigating. There are a lot of permutations, but a few generalizations are possible:

- If the value of the right is small and the cost of litigation high, then the tendency will be for nonconsensual taking of the right. A lawsuit is unlikely, however, because in the absence of a class action or a fee shifting statute, it will be too expensive. As a result, whatever norm is being protected by the liability rule will be underenforced and the muddy liability rule will not encourage disclosure of norm-related information.
- If the value of the right is large relative to the cost of litigation, then the liability rule will encourage transactions. The muddiness of the rule will reduce the value of the right, but increase the likelihood of disputes. The liability rule will encourage

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just the ones that were large enough to draw FTC scrutiny.

217. See Heller, *supra* note 23, at 624 (“When there are too many owners holding rights of exclusion, the resource is prone to underuse—a tragedy of the anticommons.”).

nonconsensual taking, and the results will be significant information-forcing, likely judicial decision making, and the attendant costs of litigation.

- If the principal uncertainty is related to valuation, the information-forcing effect of the liability rule may reduce the likelihood of litigation, irrespective of the muddiness of the rule.<sup>218</sup>
- If the principal uncertainty is created by the muddiness of the rule (norm uncertainty), the dispute is likely to center on norm-related behavior, and the muddy rule will encourage disclosure of norm-related information.
- Finally, the use of a liability rule introduces credit risk as a variable. When one party is insolvent, the deterrent effect of damages, and hence the norm-enforcing value of the rule, will be reduced.

Outside of bankruptcy, it is difficult to generalize about the effect of muddy liability. Bankruptcy simplifies the analysis, however, and highlights the distinction between muddy property and muddy liability. Remember that in bankruptcy, liability is discharged. The entitlement's value is reduced or even eliminated. A regime of muddy liability is therefore turned into a regime of virtually no liability. Muddy entitlements protected by liability rules yield no norm enforcement, and no norm-based information forcing in bankruptcy. For the purposes of this discussion, therefore, it is possible to ignore this complexity. To the extent that we are trying to choose a regime for data privacy promises in bankruptcy, the effect of bankruptcy is to eliminate the norm-enforcement effects of liability rules. Bankruptcy law discharges claims based on personal liability. Thus, any protection accorded to privacy promises in bankruptcy will have to be property-based.

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218. In a world of costless litigation this would not be the case. In a world where litigation costs money, however, a reduction in the value of an entitlement increases the probability that litigation costs will exceed the amount in dispute.

### III. MUDDY PROPERTY RIGHTS, INSTITUTIONAL CHOICE, AND SYSTEMIC INFORMATION-FORCING

#### A. *The Positive Externality of Muddy Property*

Thus, while Ayres and Talley note the information-forcing effect of liability rules,<sup>219</sup> muddy standards can have an information-forcing effect as well, and this effect is maximized by the use of muddy property rights. Muddy property rights increase the likelihood of disputes, and the need for judicial resolution of disputes.<sup>220</sup> There is a crucial difference, however, in the nature of the information-forcing effect on the "rights" axis, as opposed to the "remedy" axis. The information that is forced out by a liability rule relates to valuation. This information is important to the parties, but is not likely to be important to anyone else. Information that is forced out by litigation relates to the norms implicated by the muddy rule. The norm at issue may exist for the purpose of facilitating private ordering, or it may exist to serve a public purpose such as preserving the privacy commons and encouraging constitutive privacy. Muddy rules, and particularly muddy property rules, encourage disputes and force disclosure of facts about transactions and facts about behavior. This information may be useful to the parties in connection with their private discussions. More importantly, this information may be useful to the legal system as a whole. It is this aspect of muddy rules that bears important consideration in connection with personal data transactions in bankruptcy.

#### B. *Systemic Information-Forcing and Institutional Choice*

The public value of systemic information-forcing is recognized in the political science literature. James Rogers, in an article in the *American Political Science Journal*, shows that rational legislatures should actually prefer a regime in which courts have the power to review and overturn statutes.<sup>221</sup> He suggests that courts have an

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219. See *supra* text accompanying note 168.

220. To the extent that the dispute is resolved by a court, the litigation makes information about the parties' behavior public. Even short of litigation, however, negotiation and trial preparation generate significant amounts of information.

221. James R. Rogers, *Information and Judicial Review: A Signaling Game of Legislative-*

informational advantage when they review statutes because they act later in time, and because they have a specific set of facts in front of them.<sup>222</sup> Rogers argues that the judiciary's informational advantage is useful to legislators.<sup>223</sup> The judicial power to correct legislative errors reduces the risks faced by legislatures when they legislate, even when the courts may disagree with the legislature regarding the underlying policy.<sup>224</sup>

Rogers' model focuses on the power of courts to overrule statutes, but the informational advantage held by courts also applies when courts interpret muddied statutes. Mud allows courts to flesh out, through the use of the common law, the norms embodied in a statute. If the courts get it right, the legislature is vindicated. If the courts get it wrong, the legislature can correct the result by amending the statute.<sup>225</sup> The dynamic identified by Rogers should apply even more forcefully to courts that interpret statutes, than to courts that overturn them.

In short, a legislature may choose to legislate with open-textured rules when it is difficult to spell out legal norms with specificity. This may be true for a number of reasons: the legislature may not have sufficient information with which to craft a bright-line rule, the norm may not be sufficiently well-formed to craft a bright-line rule, or the political consensus may not be sufficiently well developed to craft a bright-line rule. In any of these situations, legislatures often choose open-ended provisions.<sup>226</sup>

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*Judicial Interaction*, 45 AM. J. POL. SCI. 84, 85 (2001).

222. *Id.* at 86.

223. *Id.* at 88.

224. *Id.* at 97.

225. See generally Daniel Bussel, *Textualism's Failures: A Study of Overruled Bankruptcy Decisions*, 53 VAND. L. REV. 887 (2000) (noting that such correction does not come without cost, and may not occur immediately).

226. William N. Eskridge, Jr., *Politics Without Romance: Implications of Public Choice Theory for Statutory Interpretation*, 74 VA. L. REV. 275 (1988). According to Eskridge:

[I]t is now commonplace for the Supreme Court to interpret generally phrased distributed benefit, distributed cost statutes—the Sherman Act, section 1983, habeas corpus law—in a common law fashion. The Court or one of the concurring Justices is sometimes quite open about the poor fit between the Court's interpretation of such statutes and any original legislative expectations. Notwithstanding this extensive, and relatively open, judicial lawmaking, there has been no hue and cry among legislators or interest groups to stop it. Members of Congress seem happy enough that the Court is making many hard policy judgments and filling in gaps found in these open-ended statutes.

Some commentators treat this as a legislative cop out, leaving the courts to make the hard decisions,<sup>227</sup> but Rogers' analysis suggests that this may also be efficient.<sup>228</sup> Muddy rules create an institutional and informational feedback loop. Muddy rules not only leave it to courts to make decisions, the muddy rule will also have the effect of forcing out norm-related information, exposing it to the parties, and, to the extent that litigation is necessary, putting that information on the record. Disputes over muddy rules get reported in the press and in judicial decisions. Even those cases that ultimately settle generate information for both the judiciary and for legislatures. Legislative and regulatory action is often driven by stories that emerge through the litigation process.

### *C. Muddy Property and Yahoo in Bankruptcy: An Illustration*

Let's return to Yahoo and bankruptcy law. Yahoo wants to sell personal information about its customers, notwithstanding its promise not to do so. Under current law there appear to be two alternative approaches to Yahoo's promise, neither of them satisfactory. If the promise is a promise and nothing more, then it is protected by a crystalline liability rule. Yahoo cannot sell customer data unless Yahoo is prepared to pay damages. If the promise is protected by a property rule, then the rule is also crystalline. Yahoo cannot sell the information at all unless the information holders consent. There are two complications however: (1) Yahoo is insolvent and may be judgment proof, and (2) there are thousands of information holders with relatively small claims. These two

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*Id.* at 312.

227. *Id.* at 288. Eskridge plays through the legislative options as follows:

A legislator seeking reelection faces the 'dilemma of the ungrateful electorate': the good things a legislator does for an interest group are forgotten more easily than the bad things are forgiven. To avoid this dilemma, a legislator will typically try to avoid or finesse 'conflictual' demand patterns.... If this cannot be accomplished, the legislator's next-best strategy will be to support an ambiguous law, with details to be filled in later by courts or agencies. *In that way, the legislator will be able to assure each group that it won, and then will be able to blame a court or agency if subsequent developments belie that assurance.*

*Id.* (emphasis added).

228. See *supra* text accompanying notes 221-24.

complications have the effect of driving the liability and property options further apart.

Yahoo's insolvency means that under a liability regime, Yahoo can sell the data and avoid paying damages. The presence of diffuse claimants means that Yahoo can sell the data, and may not even be sued. As such, a crystalline liability rule becomes a crystalline nonliability rule. Not only is there no information-forcing, there is no norm enforcement either. Under a liability rule, there is no norm enforcement in bankruptcy.

By contrast, under a property regime, Yahoo is faced with an "anticommons" problem. Customer information will be protected notwithstanding the inability of Yahoo to pay damages, and notwithstanding Yahoo's bankruptcy. The diffusion of the customers, however, eliminates the principal benefit of a property rule. On the one hand, we know that there are 20,000 customers with a property right to their personal information. On the other hand, the costs of contacting them and obtaining a consent to disclosure may be prohibitive. As such, a crystalline property rule becomes an insurmountable restriction on alienation. Norm enforcement becomes absolute, and all transactions are chilled. This is not a satisfactory outcome, either for Yahoo or as a matter of policy.

We are at a crucial moment in the law of cyberspace. It is still possible to choose the legal regime. Which institution is best situated to resolve this impasse? On the one hand, Congress could simply abandon norm enforcement and pass a law specifying that privacy policies can be overridden in bankruptcy. This would shift the burden of regulating transactions in personal information to the marketplace. Website customers would be required not only to monitor the privacy policies of the websites that they visit, but also to make a decision about the creditworthiness of the information's recipient. The infeasibility of such monitoring highlights the inadequacy of this market-based approach. The market does not, by itself, provide an efficient mechanism for allocating entitlements to nonpublic personal information. Individual disclosers are at a significant informational disadvantage when dealing with information collectors. They neither know what they are disclosing nor how that information is likely to be used.

Second, Congress could seek to strike the balance itself. In doing so, it would have to recognize that any liability-based approach

becomes ineffective upon the insolvency of the website. As such, some form of property-based approach is necessary. Congress could follow a number of property-based approaches. It could enact a crystalline rule propertizing privacy promises, but, given the current state of the market for privacy promises, this does not seem like an appropriate response. Alternatively, Congress could enact a set of rules for information sales that would apply to all transactions. This is not unlike the mandatory notice and opt-out approach attempted in the Gramm-Leach-Bliley amendments.<sup>229</sup> One problem with this approach is that, as the Gramm-Leach-Bliley amendments illustrate, the costs associated with getting the rule wrong can be prohibitive.<sup>230</sup> The privacy market is still evolving. Different types of personal information and different contexts may require different levels of protection. Medical information may require absolute protection. Financial data may require significant protection, while taste in clothing may require relatively little protection. Congress simply does not have sufficient information at its disposal to make an informed, long-term decision about such privacy policies inside or outside of bankruptcy.

Third, Congress could delegate the task of working out the details to an agency for rulemaking.<sup>231</sup> Agency rulemaking, at least in a crystalline form, while more flexible than legislation, suffers from the same problem. There simply is not enough understanding in the system about how these transactions should be governed, or about the possible abuses that might develop. Thus, crystalline rulemaking by an agency is not an adequate alternative to the market.

Finally, Congress could delegate the process of decision making to an adjudicative process. If Congress adopts a muddy rule, or if an agency promulgates a muddy rule, the ultimate decisions are likely

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229. See Janger & Schwartz, *supra* note 34.

230. On the one hand, Citigroup had to distribute ninety million privacy notices. John Schwartz, *Privacy Policy Notices Are Called Too Common and Too Confusing*, N.Y. TIMES, May 7, 2001, at A1. On the other hand, it seems few read them. Press Release, Am. Bankers Assoc., ABA Survey Shows Nearly One Out of Three Consumers Read their Bank's Privacy Notices, June 15, 2001, available at <http://www.aba.com/Press+Room/060701bankfees.htm> (last visited Feb. 25, 2003). As a reflection of the overall frustration with the notice requirement, the FTC held a workshop on December 4, 2001 to allow discussion of problems with the GLB privacy notices. *FTC Workshop Notes: Get Noticed: Effective Financial Privacy Notices*, at <http://www.ftc.gov/bcp/workshops/glb/index.html> (last visited Feb. 25, 2003).

231. See, e.g., Gramm-Leach-Bliley Act § 505, Pub. L. No. 106-102, 113 Stat. 1338 (1999).

to be made through the process of adjudication rather than contract. Uncertainty about legal norms increases the likelihood that there will be a dispute and increases the likelihood that the dispute will have to be resolved by a court. Such delegation can be accomplished either with a muddy property rule or with a muddy liability rule. If the rule is going to serve a legal norm-enforcing role when a debtor is insolvent, then it is crucial that the entitlement adopted be treated as property rather than liability. A muddy property right would have the effect of pushing the job of norm generation into the adjudicative process. The benefits would be threefold: (1) a muddy property right provides protection for privacy norms; (2) a muddy property right encourages litigation in marginal cases, and therefore, forces information into the system, and (3) a muddy property right allows judges to adapt rules to particular cases, while helping to shape the governing privacy norms.

*D. What Larry, Marc, and Jessica Don't Get*

This view of systemic information-forcing, through the use of muddy property rules, both complements and fills a gap in Lessig's proposal for propertizing personal information.<sup>232</sup> Moreover, it also responds to the concerns of critics like Rotenberg and Litman who oppose propertization.<sup>233</sup> When speaking of data privacy, Lessig appears to believe that propertization and technology will solve the data privacy problem.<sup>234</sup> Following my colleague Paul Schwartz, however, I have shown that propertization and bargaining alone will not solve the problem, or at least not yet. Lessig sees a role for public institutions, and for judges in particular, to aid the development of the law of cyberspace. Lessig states that "judges—especially lower court judges—should be stronger. Lower court judges, because there are many of them and because many are extraordinarily talented and creative. Their voices would teach us something here, even if their rulings were temporary or limited in scope."<sup>235</sup> Lessig fails, however, to identify a mechanism for

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232. LESSIG, *supra* note 7, at 140.

233. Rotenberg, *supra* note 11; Litman, *supra* note 145; see also McGeveran, *supra* note 148.

234. LESSIG, *supra* note 7, at 156-63.

235. *Id.* at 222.



obtaining this involvement. Muddy property needs to be part of Lessig's program. The Internet—and the way people use it, is evolving quickly. As such, bright-line rulemaking that seeks to govern privacy transactions precisely is likely to yield rules that are outmoded almost as soon as they are promulgated. This suggests that judicial decision making, rather than closed-ended crystalline legislation, is more appropriate for governing privacy transactions. Lessig recognizes that translating and transforming public values in this new environment is a task that is uniquely suited to judges. Lessig writes: "I would rather err on the side of harmless activism than on the side of debilitating passivity. It is a tiny role for courts to play in the much larger conversation that we need to have—but to date have not started."<sup>236</sup> If judges are to play the role that Lessig envisions, the property rights created to protect privacy will have to be muddy ones.

What Rotenberg and Litman don't get is that, in the era of the dot-com bust, many transactions in personal information will take place in bankruptcy. Thus, propertizing private information makes sense and may indeed be necessary. In a judgment-proof world, commodification should be the least of Rotenberg and Litman's worries. If Rotenberg's regulation and Litman's tort are based in liability, privacy norms will go utterly unenforced in bankruptcy. In short, although commodification of personality may be a risk associated with propertization of personal information, the response is *not* to fight property but to try to shape it.

Finally, there is something that neither Lessig nor Rotenberg and Litman get. Propertization can create an anticommons. Only a collective proceeding, like Chapter 11 of the Bankruptcy Code, provides a forum in which judicial decision making can operate to both protect privacy norms and preserve the value of data compilations. Lessig misses this point because he is concerned with using property to create a privacy market, and Rotenberg misses it because he is busy resisting property. To the extent that databases like those maintained by Toysmart are valuable, their value lies not in the information about any one person but in the fact that they contain data about many people.

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236. *Id.* at 223.

Propertization gives every web surfer the right to veto the transfer of her personal information. Given the number of visitors and the small value of each datum, there is a tremendous likelihood that these surfers will face coordination problems, if they want to enforce their property rights or if it is in their best interests as a group to waive them. Propertization creates the need for a collective procedure for quieting title in customer databases. Bankruptcy judges are uniquely situated to accomplish this task.

#### IV. EVALUATING THE LEAHY AMENDMENT: MUDDY PROPERTY AND FAIR INFORMATION PRACTICES IN BANKRUPTCY

##### A. *The Leahy Amendment*<sup>237</sup>

The Senate's version of the Bankruptcy Reform Bill of 2001 contained a provision that was intended to insure that debtors live up to their "privacy promises." Although the Bill did not become law, the proposed provision is at once promising and frustrating. On the promising side, it clearly resolves the property/liability conundrum discussed above. The amendment would have been inserted into § 363 of the Bankruptcy Code—the section that authorizes the trustee to "use, sell, or lease" property of the estate.<sup>238</sup> The amendment would make it clear that personal information is to be viewed as property. It would also take the form of a muddy rule because it would allow the bankruptcy court to override a privacy policy "after notice and hearing."<sup>239</sup> Its promise, however, ends here. Like Lessig, the Leahy Amendment got the remedial question right but took some wrong turns once it got down to the business of defining norms.

The first wrong turn was that the Leahy Amendment was actually *too* muddy.<sup>240</sup> The provision stated that whenever a debtor has published a privacy policy, the debtor could not disclose personal information in a manner inconsistent with its privacy policy, unless the court approved the sale after notice, hearing, and "consideration

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237. See Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 231(a)(1)(B) (2001).

238. 11 U.S.C. § 363(b)(1) (2000).

239. S. 420, 107th Cong. § 231(a)(1)(B).

240. Section 231 of Senate Bill 420 is set forth in full in the Appendix to this Article.

of the facts and circumstances.”<sup>241</sup> The provision was silent on which “facts and circumstances” might justify a sale in violation of a privacy policy. This was an extraordinarily muddy rule because it said nothing more. In its muddiness, the statute failed entirely to specify what, if anything, the bankruptcy judge should be doing. The Leahy Amendment was not just muddy, it was a blind legislative punt to the judiciary. It gave no guidance to parties trying to structure their transactions without court intervention.

Some of this concern was mitigated because the next section of the statute provided for the appointment of a “privacy ombudsman” to represent the customers whose personal information was at issue.<sup>242</sup> Any time that a trustee proposes to sell personal information in a manner that is inconsistent with a privacy policy, “the trustee shall request, and the court shall appoint” a privacy ombudsman.<sup>243</sup> In addition, the Bill gave some guidance to the ombudsman about the nature of the values at stake:

(2) DUTIES OF OMBUDSMAN- It shall be the duty of the ombudsman to provide the court information to assist the court in its consideration of the facts, circumstances, and conditions of the sale or lease .... Such information may include a presentation of the debtor’s privacy policy in effect, potential losses or gains of privacy to consumers if the sale or lease is approved, potential costs or benefits to consumers if the sale or lease is approved, and potential alternatives which mitigate potential privacy losses or potential costs to consumers.<sup>244</sup>

This allocation of responsibility is peculiar. The Bill told the ombudsman what he should bargain for, but it said nothing about how the court should exercise its discretion when bargaining fails.

The second wrong turn arose because the Leahy Amendment was too clear. If a data sale was permitted by the dot-com’s privacy policy, then it was to be permitted without judicial intervention. This crystalline delegation of responsibility to the privacy marketplace relied too heavily and naively on party autonomy. If Yahoo,

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241. S. 420, 107th Cong. § 232(a)(2).

242. Section 232 of Senate Bill 420 is set forth in full in the Appendix to this Article.

243. S. 420, 107th Cong., § 232(a)(1).

244. *Id.* § 232(a)(2).

instead of drafting a "hard" privacy policy, had adopted a policy more like that of Amazon.com, which said, in effect, "we'll sell your information if we feel like it," then Yahoo would be free to sell the data without consent or court intervention.

This faith in party autonomy is misplaced. Thus far, this Article has focused on privacy policies that promise to protect privacy. Not all policies are of this type. Although some privacy policies contain a promise of confidentiality, many, if not most, would be better described as data disclosure policies, setting forth the terms upon which data will be shared. Many of these run to six pages of fine print. Often they go unread. Even consumers who consent under such policies may be entitled to some protection against certain types of data sales. In this regard, the Leahy Amendment, like Lessig, placed too much faith in a privacy marketplace that does not exist and is not likely to come into existence without some judicial and legislative prodding.

On the plus side, the Leahy Amendment created a muddy property regime, provided a representative for unrepresented interests, and created a mechanism (the bankruptcy court) for quieting title.<sup>245</sup> Legislation offering judicial decision making, a forum for norm articulation, and a mechanism for overcoming coordination and anticommons-type problems is no small accomplishment. There was also a significant negative side to the equation, however. First, the muddy rule articulated by the Leahy Amendment was so unclear as to be utterly without form. Second, it was likely to have limited impact in a world where most so-called privacy policies give the website considerable latitude to sell customer information.

### *B. Towards a FIPs Default*

Rather than whipsawing between undifferentiated mud to determine when a privacy policy can be modified, and a naive crystal, that defers to any privacy policy, no matter how promulgated and no matter how permissive, proposed privacy legislation should take a more unified approach. All privacy promises should be subject to a provision that propertizes personal information, articulates broad norms for personal information transactions, and establishes

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245. See Appendix, *infra*.

defaults which can only be overcome by the express consent of the parties, if at all. The Leahy Amendment was prepared to allow bankruptcy judges to write on a *tabula rasa*. This was unnecessary. Although cyberlaw is new, it is not that new. Privacy scholars like Schwartz, Litman, and Rotenberg have spent much of the last few years thinking deeply about the privacy norms that should govern personal information transactions. These privacy norms, or FIPs, have evolved over time:

During the 1970s, some eighty years after Warren and Brandeis identified the privacy tort, the United States developed ... [Fair Information Principles or] FIPs as a new tool for privacy protection. By the start of the 1980s, FIPs had coalesced into their current form. Currently expressed in statutes such as the Video Privacy Protection Act, the Privacy Act, and the Cable Communications Act, FIPs offer great promise for Internet privacy. Although the expression of FIPs in different laws, regulations, and proposals varies in details, sometimes crucially, these standards generally require four things: (1) the creation of defined obligations, often statutory in nature, with respect to the use of personal information; (2) the maintenance of processing systems that are understandable to the concerned individual (transparency); (3) the assignment of limited procedural and substantive rights to the individual; and (4) the establishment of effective oversight of data use, whether through individual litigation (self-help), government and private scrutiny (external oversight), or some combination of these approaches.<sup>246</sup>

These FIPs can help establish a floor beneath which privacy policies cannot sink and can also establish a range of defaults.<sup>247</sup> If protection of privacy norms is to be meaningful in bankruptcy, however, such protection must be accorded the status of property. Finally, there must be a collective mechanism available, such as the bankruptcy court, that will provide a forum for application of FIPs and representation of unrepresented interests when the transfer of large databases is at stake.

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246. Schwartz, *Lessig's Code*, *supra* note 109, at 779-80.

247. For a discussion of the remedy provisions of the various existing privacy statutes, see Janger, *supra* note 23.

*C. Some Reflections on Forum Shopping*

An additional concern about the Leahy Amendment is that it created a rule and a mechanism that would exist inside bankruptcy but not outside. The statute would have limited the transfer of personal information inside bankruptcy in a way that does not exist outside of bankruptcy. As discussed above, if a debtor seeks to sell personal information outside of bankruptcy, it takes certain risks, but those risks are limited by the fact that claimants are diffuse, and a suit is unlikely. By contrast, inside bankruptcy, the sale cannot take place without court approval.

This aspect of the rule might cause forum shopping out of bankruptcy. Debtors might seek to sell data outside of bankruptcy in order to avoid the procedural restrictions of the Leahy Amendment. On the other hand, a debtor who has a nervous buyer and wishes to sell data may find it attractive to sell the data through bankruptcy so that it can take advantage of the Leahy Amendment's mechanism allowing the bankruptcy court to bless the data sale. This may cause forum shopping into bankruptcy. In addition to property rules inside bankruptcy, therefore, another statute should perhaps be enacted which provides individuals with muddy property-like protection for their personal data but provides the potential data seller with recourse to a collective proceeding like that available in bankruptcy for facilitating sales of data in a manner consistent with customer expectations.<sup>248</sup>

#### CONCLUSION

In sum, muddy property and bankruptcy judges should play a crucial role in the development of legal norms to govern transactions in personal information that involve an insolvent debtor. Property rules have a unique role to play because of their capacity to enforce norms notwithstanding the insolvency of the debtor. Muddy property has the capacity to force disclosure of norm-related information to the parties, the judge, and the legal system as a whole. It therefore has the potential to foster discussion about the appropriate norms to govern transactions in personal information

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248. *See id.*

and to aid in the articulation of FIPs. Bankruptcy law and, more importantly, bankruptcy courts, have a particular role to play in enforcing and developing such privacy norms. In the current economy, many sales of personal information involve insolvent or bankrupt entities. The bankruptcy court provides a collective proceeding for quieting title in personal information and determining the terms and conditions of information sales. Bankruptcy courts offer an attractive forum for articulating privacy norms and remedying the anticommons problem that may arise when a website seeks to sell its data. If privacy norms are to be developed by public processes rather than the market with all its imperfections, the incremental and dialogic attributes of the common law are essential. Muddy property-based entitlements organized around FIPs are a promising approach that should have the happy consequence of establishing courts as guardians of information privacy.

APPENDIX—THE LEAHY AMENDMENT TO S. 420, THE  
BANKRUPTCY REFORM ACT OF 2001

SEC. 231. PROTECTION OF NONPUBLIC PERSONAL  
INFORMATION.

(a) IN GENERAL- Section 363(b)(1) of title 11, United States Code, is amended by striking the period at the end and inserting the following:’, except that if the debtor has disclosed a policy to an individual prohibiting the transfer of personally identifiable information about the individual to unaffiliated third persons, and the policy remains in effect at the time of the bankruptcy filing, the trustee may not sell or lease such personally identifiable information to any person, unless—

‘(A) the sale is consistent with such prohibition; or

‘(B) the court, after notice and hearing and due consideration of the facts, circumstances, and conditions of the sale or lease, approves the sale or lease.’.

(b) DEFINITION- Section 101 of title 11, United States Code, is amended by inserting after paragraph (41) the following:

‘(41A) ‘personally identifiable information’, if provided by the individual to the debtor in connection with obtaining a product or service from the debtor primarily for personal, family, or household purposes—

(A) means—



'(i) the individual's first name (or initials) and last name, whether given at birth or adoption or legally changed;

'(ii) the physical address for the individual's home;

'(iii) the individual's e-mail address;

'(iv) the individual's home telephone number;

'(v) the individual's social security number; or

'(vi) the individual's credit card account number; and

'(B) means, when identified in connection with one or more of the items of information listed in subparagraph (A)—

'(i) an individual's birth date, birth certificate number, or place of birth; or

'(ii) any other information concerning an identified individual that, if disclosed, will result in the physical or electronic contacting or identification of that person;'

#### SEC. 232. CONSUMER PRIVACY OMBUDSMAN.

##### (a) IN GENERAL-

(1) APPOINTMENT ON REQUEST- If the trustee intends to sell or lease personally identifiable information in a manner which requires a hearing described in section 363(b)(1)(B), the trustee shall request, and the court shall appoint, an individual to serve as ombudsman during the case not later than—

(A) on or before the expiration of 30 days after the date of the order for relief; or

(B) 5 days prior to any hearing described in section 363(b)(1)(B) of title 11, United States Code, as amended by this Act.

(2) DUTIES OF OMBUDSMAN- It shall be the duty of the ombudsman to provide the court information to assist the court in its consideration of the facts, circumstances, and conditions of the sale or lease under section 363(b)(1)(B) of title 11, United States Code, as amended by this Act. Such information may include a presentation of the debtor's privacy policy in effect, potential losses or gains of privacy to consumers if the sale or lease is approved, potential costs or benefits to consumers if the sale or lease is approved, and potential alternatives which mitigate potential privacy losses or potential costs to consumers.

(3) NOTICE TO OMBUDSMAN- The ombudsman shall receive notice of, and shall have a right to appear and be heard, at any hearing described in section 363b(1)(B) of title 11, United States Code, as amended by this Act.

(4) CONFIDENTIALITY- The ombudsman shall maintain any personally identifiable information obtained by the ombudsman under this title as confidential information.

(b) APPOINTMENT- If the court orders the appointment of an ombudsman under this section, the United States Trustee shall appoint 1 disinterested person, other than the United States trustee, to serve as the ombudsman.

(c) COMPENSATION OF CONSUMER PRIVACY OMBUDSMAN- Section 330(a)(1) of title 11, United States Code, is amended in the matter preceding subparagraph (A), by inserting 'an ombudsman appointed under section 332,' before 'an examiner'.

