September 11, 2008

Chairman William E. Kovacic
Federal Trade Commission
600 Pennsylvania Avenue, NW
Washington, D.C. 20580

SUBMITTED BY FAX AND REGULAR MAIL

Re: Protect Consumers' Money Held on Bankrupt Retailers' Gift Cards

Dear Chairman Kovacic:

Consumers Union, the nonprofit publisher of *Consumer Reports* ®, Consumer Federation of America, the National Consumer Law Center (on behalf of its low income clients), and U.S. PIRG call upon the Federal Trade Commission to protect consumers from losing billions of dollars held on retailer gift cards.[1] This comes at a particularly important time as more large retailers file for bankruptcy.

Gift cards do not have adequate consumer protections, particularly when a retailer files for bankruptcy. Consumers are now discovering their gift cards may be greatly devalued or not worth anything at all when a retailer declares bankruptcy. There is no guarantee to consumers that they will be able to obtain the prepaid value on their gift cards from struggling or bankrupt retailers.

Currently, unused gift card funds are treated as a debt and to honor the card the bankruptcy court orders the retailer to honor the card. The retailer may or may not request the court to allow it to continue to accept its gift cards. The consumer is left without the ability to use the card if the retailer does not make this request or if the court denies the retailers' request. The consumer may be left with one option, which is the cumbersome task of filing a claim as an unsecured creditor in the bankruptcy proceeding to obtain the value on their gift card.

For example, consumers with Sharper Image gift cards suddenly held significantly diminished or worthless cards when the retailer filed for bankruptcy early this year. Initially, consumers were left empty-handed when Sharper Image ceased accepting its

[1] "Retailer" includes all merchants that provide consumer goods and services, including restaurants.

gift cards when it filed for bankruptcy. At that time, an estimated $20 million remained unused on outstanding gift cards.[2]

Then, Sharper Image petitioned the court to allow it to accept its own gift cards when consumers spent twice the value on a gift card in a single transaction. This occurred only after a major competitor began to provide a 25% discount for consumers with Sharper Image gift cards.[3] The retailer has since shut its doors. Consumers who still want to obtain the value on their Sharper Image gift cards now must do so by filing as unsecured creditors in the bankruptcy proceeding, a process that involves paperwork and is likely to take years.[4]

Consumers have an enormous amount of money on retailer gift cards that needs protection. The TowerGroup estimated that in 2006, approximately $80 billion was spent to purchase gift cards.[5] The same research firm found that about $8 billion remained unredeemed on gift cards in 2006.[6] Additionally, consumers do not know whether they may suddenly be carrying, or even worse, purchasing, worthless gift cards. To eliminate this problem, the FTC should declare it an unfair and deceptive practice for retailers to sell gift cards without segregating and holding in trust gift card funds to guarantee that consumers will be able to use their gift cards and obtain the value on their cards in the event of a retailer's bankruptcy.

We ask **the FTC to protect consumers from losing money on gift cards sold by retailers**. To provide consumers with a permanent solution, the FTC should:

- Declare the **sale of gift cards without <u>both</u> segregating the funds and holding those funds in a trust to be an unlawful and deceptive practice**; and
- Prescribe **new rules that require retailers to both segregate and hold in trust gift card funds, and to automatically honor a consumer's gift card** from those

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[2] Sharper Image's Motion to Honor Certain Prepetition Customer Programs, filed and entered on February 20, 2008, states approximately $20 million on gift certificates, which includes Massage Chair Certificates, remained unredeemed at the date of filing. This does not include the face value of Merchandise Certificates, which was approximately $23 million. Merchandise Certificates were provided in consideration of refunds or exchanges or sold in connection to corporate sales promotions. *In re* TSIC, Inc., f/k/a Sharper Image Corporation, 2008 Bankr. LEXIS 2207 (2008). A May 2008 Tower Group executive summary for its study, *Charred Card: Private-Label Gift Cards Stumble in a Weak Economy*, estimated that consumers lost $60 million in value due to the Sharper Image bankruptcy filing.

[3] A March 11, 2008 *Consumer Reports Money* blog reported on the problem with Sharper Image gift cards, http://blogs.consumerreports.org/money/2008/03/sharperimage_gi.html?resultPageIndex=1&resultIndex=2&searchTerm=gift%20card%20sharper%20image

[4] Sharper Image gift card holders may also use their gift cards with a major competitor as long as it continues to offers a 25% discount, or file a claim with the credit card issuer, if the card was purchased by the consumer with a credit card. Sharper Image gift cardholders have sought certification as a class in the retailer's bankruptcy proceeding to "give the holders a stronger bargaining position." *Gift Card Holders of the World, Unite!*, Wall Street Journal Deal Journal, September 4, 2008.

[5] *With Soaring Gift Card Sales Poised to Exceed $80 billion in 2006, Unused Card Values Are Also on the Rise*, TowerGroup Press Release, November 20, 2006.

[6] *With Soaring Gift Card Sales Poised to Exceed $80 billion in 2006, Unused Card Values Are Also on the Rise*, TowerGroup Press Release, November 20, 2006.

segregated funds for goods or services until or unless a bankruptcy court orders otherwise.

Consumers require intermediate protections while the FTC develops and implements new rules that require gift card funds to be segregated and held in trust. The FTC should also do all of the following:

- **Intervene in bankruptcy proceedings** to request the court to order that a bankrupt retailer accept its own gift cards at full value as long as the doors remain open;
- **Develop and maintain a new FTC registry on bankrupt retailers' gift card practices**;
- **Require retailers to report to the new FTC registry when the retailer files for bankruptcy**, and make this information public within one business day;
- **Require bankrupt retailers to stop selling gift cards no later than the date of the bankruptcy filing**;
- Require retailers to **inform third party vendors to immediately cease sale** of any bankrupt retailers' gift cards; and,
- Require **third party vendors to immediately cease sale of gift cards for bankrupt retailers**.

Importance of Segregation of Funds and Maintaining Funds in a Trust
Consumers have prepaid for goods and services for themselves or others when they purchase gift cards, and have the expectation they will be able to obtain the value on their gift cards. The TowerGroup in May 2008 reported that "[y]ear-end 2007 filings indicate that retailers currently hold billions of dollars in stored-value cards.[7]" And at the same time, more large retailers file for bankruptcy protection. Under the current process, it is highly uncertain whether or not the consumer will be able to obtain the goods and services already paid for when a retailer files for bankruptcy. The FTC should declare the **sale of gift cards without both segregating the funds and holding the funds in a trust to be an unfair or deceptive practice**.

Although retailers may intend to continue to accept gift cards to maintain customer loyalty and goodwill when under bankruptcy protection, many retailers do not have the funds to cover the value of outstanding gift cards. The Linens' N Things' bankruptcy filings provide a good depiction of just this--the retailer had not set aside the funds placed on gift cards. Linens' N Things requested the court to allow its stores to continue to accept gift cards at full value despite "not [having] maintain[ed] a cash reserve amount to fund outstanding Gift Cards.[8]" The company estimated that the "typical redemption of Gift Cards is approximately $9.25 million on a monthly basis.[9]

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[7] *Charred Card: Private-Label Gift Cards Stumble in a Weak Economy*, TowerGroup Executive Summary, May 26, 2008.
[8] *In re* Linens Holdings Co, 08-10832-CSS (Bankr. Del., May 2, 2008) *available at* https://pacer.login.uscourts.gov/cgi-bin/login.pl?court_id=00idx.
[9] *In re* Linens Holdings Co, 08-10832-CSS (Bankr. Del., May 2, 2008) *available at* https://pacer.login.uscourts.gov/cgi-bin/login.pl?court_id=00idx.

The FTC should **promulgate a new rule that requires retailers to both segregate and hold in trust gift card funds, and to automatically honor a consumer's gift card** for goods or services until or unless a bankruptcy court orders otherwise. Such a rule would require both the segregation of gift card funds, and maintenance of these gift card funds in a trust. California and Washington laws both impose a trust in an attempt to better protect consumers from losing the value on their gift cards when retailers are in bankruptcy.[10]

We understand that in order for consumers to obtain the value on their gift cards after the funds are segregated and held in trust, the bankruptcy court still must approve a request from the company to continue to accept its own gift cards. However, without requiring segregation and maintenance of gift card funds by retailers in a trust, consumers will continue to lose millions on gift cards.

The FTC's New Rule should also Require Retailers to Honor the Retailers' Own Gift Cards at the Retailers' Stores and Websites So Long as the Doors Remain Open

Requiring a consumer to file as an unsecured creditor in a bankruptcy proceeding is cumbersome and uncertain. The TowerGroup study agrees, stating that "consumers are often unsecured creditors with little promise of realizing the cash value on their card" with bankrupt retailers. [11] The FTC should permanently put an end to millions of dollars in gift card losses suffered by consumers by requiring the segregation of gift card funds and maintaining these funds in a trust and enabling consumers to automatically redeem the value on their gift cards directly with the bankrupt retailer as long as its doors remain open.

The FTC Should Intervene in a Retailer's Bankruptcy Proceeding on Behalf of Consumers

We request that the FTC closely monitor retailers who have filed for bankruptcy to ensure that consumers will continue to be able to obtain the value on their gift cards. The FTC should intervene in bankruptcy proceedings to ensure that when retailers make requests to continue to accept gift cards, retailers make this request to do so at full value for as long as they remain open. Retailers should not be able to sell gift cards once they file for bankruptcy protection.

Today, the bankrupt retailer decides whether to seek court permission to honor outstanding gift cards. Without any regulatory or statutory requirement for gift card funds to be segregated and held in trust for consumers, consumers are unable to obtain the value on their gift cards without the retailer's choice to seek a court order. If the retailer does not seek to continue to accept gift cards, consumers must go through a cumbersome bankruptcy claim process. Until the FTC has completed a new rule

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[10] Cal Civ Code 1749.6 and RCW 19.240.090. These statutes impose the trust but may also need to require segregation of funds to be fully effective in bankruptcy.

[11] *Charred Card: Private-Label Gift Cards Stumble in a Weak Economy*, TowerGroup Executive Summary, May 26, 2008.

requiring segregation and maintenance of gift card funds and automatic redemption with the retailer, the FTC should intervene in retailer bankruptcy proceedings on behalf of consumers to ask the court to order that these cards be honored as long as the doors or website remains open.

The FTC Should Develop and Maintain a Registry on Bankrupt Retailers
Consumers cannot be expected to know whether or not a retailer segregated gift card funds or if those funds are held in trust. Retailers continue to sell gift cards even after filing for bankruptcy. It is unlikely that consumers would continue to purchase gift cards from bankrupt or financially struggling retailers who cannot guarantee gift cards will be accepted for the value already paid. A retailer should be required to inform the FTC within one business day of its bankruptcy filing about its gift card policies, especially providing information on whether the retailer has segregated gift card funds and whether the funds are held in trust solely to redeem the value on gift cards.

The FTC's new registry should include information on the date the bankruptcy was filed, the estimated value of unredeemed gift card funds, whether the gift card funds have been segregated, whether the retailer has sought bankruptcy court permission to honor its gift cards, whether the retailer's request was to continue to accept gift cards at full value, the result of its request to the court to allow it to continue to accept gift cards and at what value, the date on which the retailer stopped selling gift cards and the date which the retailer informed third party vendors to stop selling its gift cards. This registry should be offered to the public.

Third Party Vendors Must Cease Sale of Bankrupt Retailers' Gift Cards
The FTC should also require that **bankrupt retailers immediately direct third party vendors to cease selling bankrupt retailers' gift cards**. Many retailers sell gift cards through third party vendors, such as convenience stores, grocers, drug stores and online.

Gift cards from a bankrupt retailer should be removed from the shelves and websites of third party vendors the same day that the retailer files for bankruptcy. Put simply, consumers should not be offered gift cards that may not have value. We have a first-hand account of Sharper Image gift cards for sale by a third party vendor months after Sharper Image filed for bankruptcy and had already determined that it would not be accepting gift cards for full value.

Retailers should also be **prohibited from selling gift cards to third party vendors once they file for bankruptcy protection**. Likewise, the FTC should **require third party vendors to remove from sale gift cards for bankrupt retailers immediately**. This will also ensure that third party vendors will not sell valueless products to the public.

Consumers should have the proper protections for products already paid for; they should continue to have the ability to obtain their gift cards' full value even when the retailer is bankrupt. In order for this to be achieved, the FTC must promulgate a new rule for gift card funds to be segregated and held in trust. Consumers should also be able to automatically redeem the value on their gift cards for goods or services instead of going through the cumbersome process of filing as unsecured creditors in a retailer's bankruptcy proceeding. The FTC should intervene in retailers' bankruptcy proceedings on behalf of consumers and in other appropriate court orders, monitor bankrupt and struggling retailers, and require both retailers and third party vendors to cease the sale and distribution of gift cards of bankrupt entities.

We urge that this issue be resolved before consumers begin this year's holiday shopping, when billions are spent, and maybe lost, on gift cards. We look forward to working with the FTC to ensure that consumers will retain the full value on their gift cards as retailers file for bankruptcy protection.

Sincerely,

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