

The Unintended Beneficiary:
Gifting, Gift Cards & The Retail Industry (unpublished draft)

State unclaimed property laws are often referred to as “comprehensive” in scope, but the fact of the matter is that each state’s unclaimed property law exempts one or more types of transactions. Kentucky exempts mineral royalties; Maryland exempts consumer rebates; Nevada exempts (surprise!) unredeemed gaming chips and tokens. A number of states exempt “business-to-business” transactions, where unclaimed property is held by one business entity and owed to another. However, no unclaimed property exemption is as intriguing – or as monetarily substantial – as unclaimed gift cards, which, as a result of a tremendous lobbying effort by retailers, are effectively exempt from more than half of the states’ statutes. Moreover, as a result of the corporate organization and recordkeeping practices of the gift card issuers, the states which do claim gift cards never actually receive the funds representing unused card balances.

Somewhere along the line, a substantial portion of America’s population lost its gift-giving creativity (or simply became preoccupied with other tasks), and turned to gift cards. Cash may be the ultimate gift, but in most circles apparently a gift card is less crass. A number of credible authorities estimated that gift card sales exceeded around \$70 billion in 2007 (this figure represents “closed loop” cards – which can only be used at a specific retailer or restaurant – and does not include “open loop” cards – which are typically issued by banks and can be used

just about anywhere). However, what is even more incredible is the estimated “breakage” – the amount of gift card balances that remain unused. These same authorities believe that as much as 10 percent of all gift cards will never be used. If indeed \$7 billion in gift card breakage is created each year, this figure would significantly surpass the estimated \$5 billion that the states receive in unclaimed property remittances each year, *from all other sources combined*. And even if the estimate of gift card breakage is wildly overstated – the amount of unused gift card balances is very, very significant.

Gift card recipients fail to use their cards for a number of different reasons, (lost or forgotten cards, expiration dates, dislike of retail establishment), but what is most interesting from an unclaimed property perspective is that in the vast majority of cases, the card issuer keeps the unused card balance. Retailers had long-resisted state efforts to collect unclaimed gift certificates, and by the early 1990s, when gift certificates had evolved into the highly-popular gift card, the push was on to secure exemption from state unclaimed property laws. Initially, when gift cards first came into vogue, many included terms and conditions that were less than friendly to the consumer, such as “service charges” (a euphemism for what was in fact an inactivity fee) and card expirations. When consumer groups became increasingly critical of these policies and retailers were faced with the need to abandon them, they approached numerous state legislatures with an offer that was seemingly too good to refuse: we will agree to not charge your citizens any card fees and we will even agree to honor them forever; all you have

to do is exempt gift cards from the unclaimed property law. To buttress their case, retailers argued that it little sense to turn over gift card balances to the state, because the names and addresses of the owners were not known and the state could not possibly reunite them with their money (by accepting this part of the argument, state legislatures in effect overlooked hundreds of years of English and American common law, under which the “windfall” from lost property is to inure to the benefit of all citizens). State unclaimed property programs were unable to overcome the argument that allowing unused gift card balances with retailers was for the good of the consumer. (And the benefits of exemption were substantial for some retailers: \$43 million in breakage taken into income by Home Depot, \$30 million by Limited Brands, \$29 million by BestBuy, just to name a few of the public companies that disclosed one-time “true-ups” of outstanding gift card balances.)

However, not everything is peachy at the mall. As *The New York Times* recently observed in a November 22, 2008 article entitled “The Gift Card Comes Wrapped in Growing Risk,” a retailer’s commitment to forever honor a gift card cannot be viewed as an absolute. With some retailers filing for bankruptcy (and, given the financial climate, more likely to follow), there is no statutory or regulatory procedure that ensures all holders of gift cards will receive full value. While a retailer attempting to undergo reorganization would be motivated to honor (and continue to sell) gift cards, it is not required to do so. Where the retailer undergoes liquidation, the proposition for the consumer is even riskier

(just ask gift card holders of Sharper Image and Linens ‘n Things, entities that during their liquidation enacted a bizarre matrix of limitations, severely retarding gift card exercise).

Brian Riley, a senior analyst with the TowerGroup (a research advisory firm that closely tracks the gift card industry), was quoted in the *New York Times* piece that as a result of retailers going out of business in 2008, consumers were unable to use “about \$100 million in gift cards.” What can be done to prevent a recurrence in 2009? Consumers Union, the publisher of Consumer Reports, has for many years described gift cards as “a dicey proposition” and, in addition to forewarning consumers, has sought regulation of the gift card industry.

Recently, Consumers Union joined the Public Interest Research Group, the Consumers Federation of America and the National Consumer Law Center contacted the Federal Trade Commission, and advocated that the FTC push for bankruptcy protection for unused gift card balances.

There may be an easier approach than amending the Bankruptcy Code. Repealing state exemptions for unused gift cards would transfer the liability (at least as to card balances that had reached the abandonment period) to state government. Holders of unused gift cards could reclaim their balances from the state, in perpetuity. In the current environment, this seems to favor the consumer more than does the status quo. Certainly, there are important public policy issues about shifting (in many cases) tens of millions of dollars away from a retailer’s bottom line. But at this era in history, the concept of this type of

unclaimed property benefiting the general citizenry rather than boosting the profits of a single business will likely be revisited.