House of Cards

By Reg P. Wydeven
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When I was a teenager, my uncle, who loved music, would always get me an Exclusive Company gift certificate for Christmas. He would usually tape the envelope with the trademarked cursive "Exclusive Company" script on it to the back of a cheesy album, like one from Paul Anka. I hate to admit it, but the first three or four years I was always fooled.

Some relatives got me nerdy sweaters or socks, but the gift certificate was always awesome. I usually bought a Frank Sinatra or a Kiss CD. While many people feel gift certificates are impersonal, I always used mine to get a CD I really wanted.

Apparently, more and more people are thinking like me these days. According to the National Retail Federation, last holiday season, consumers spent an estimated $26.3 billion on gift cards at retailers alone, compared to $24.8 billion in 2006 and $18.48 billion in 2005. Gift cards to Target, Starbucks or Blockbuster make great presents for teachers, mail carriers, high school graduates or anyone you want to recognize. That is, so long as the company that issued the card doesn't go out of business.

Take The Sharper Image, for example. The upscale gadget retailer announced earlier this year that it was suspending the acceptance of gift cards, at least temporarily. This is standard operating procedure for a business that reorganizes under Chapter 11 bankruptcy. Under such a bankruptcy, gift cards are treated as a loan to the company, as opposed to cash.

Therefore, gift card holders are categorized as unsecured creditors, who have the least likelihood of being repaid out of a bankruptcy. Secured creditors, whose debts are collateralized by business assets such as real estate, fixtures and equipment or accounts receivable, have the best chance of recouping their losses.

This doesn't bode well for gift card recipients for 2008. In today's volatile economy where consumers are tentative to spend, more and more retailers and restaurants are either filing for bankruptcy or going out of business. The number of retail bankruptcies or liquidations this year is expected to reach the highest levels since the 1991 recession. Accordingly, experts project that more than $75 million worth of gift cards may become worthless by the end of the year. Of course, this number doesn't include small, locally owned businesses that go under.

Suspending the acceptance of gift cards is the worst thing that can happen to a holder. However, many consumers have also dealt with the headaches of having their gift cards unknowingly expire or have fees imposed if the cards are not used by a certain date. More than 20 states have passed regulations relaxing restrictions on the use of gift cards.

If a company is purchased through a Chapter 11 bankruptcy, the buyer could elect to honor the gift cards. For example, the jewelry and home furnishings chain Fortunoff agreed last month to sell to the parent company of Lord & Taylor department stores, which plans to expand the Fortunoff chain and to honor outstanding gift cards. The company is believed to have done about $32 million in business last year from gift cards.

But just to be safe, if you've got a gift card from a company rumored to be going out of business, go shopping.