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RadioShack Case Examines Treatment of Gift Cards in Bankruptcy

The holiday season is upon us. Shoppers everywhere are picking up retail gift cards to give as gifts and stocking stuffers.

I try to use gift cards as soon as possible after receiving them, otherwise there is a high likelihood that the gift cards will sit in a drawer in my kitchen, long-forgotten and unlikely to be redeemed. There is another reason, however, that it makes financial sense to redeem gift cards sooner rather than later: the uncertainty of the card's value if the issuing store files for bankruptcy.

The Bankruptcy Code does not specify the manner of treatment for holders of claims relating to unused gift cards. In a reorganizing chapter 11 case, the debtor will oftentimes obtain permission from the court to continue its customer programs, which will include honoring its outstanding gift cards.¹ When a debtor is undergoing liquidation, however, the treatment of such claims can vary widely. The bankruptcy case of RadioShack Corporation and its affiliated debtors (collectively, "RadioShack") involved many complex issues relating to the treatment of gift card claims, including whether such claims should be treated as general unsecured claims or claims entitled to priority status under the Bankruptcy Code.

The RadioShack Bankruptcy Cases

RadioShack filed for chapter 11 bankruptcy protection in the U.S. Bankruptcy Court for the District of Delaware on February 5, 2015. As part of its first day filings, RadioShack filed a motion to continue certain customer programs, including maintaining its refund policies, sales promotions, coupons, credit cards and gift cards. RadioShack stated that it would not issue any new gift cards following the date of the bankruptcy filing, but that it would continue honoring outstanding gift cards for a period of third days following the filing.³

In June 2015, RadioShack filed a Joint Plan of Liquidation (the "Plan") and corresponding disclosure statement in which RadioShack indicated that the total unredeemed gift card balance was approximately \$46 million.⁴ The Plan recognized gift card holder claims over \$10 and classified such claims as general unsecured claims unless they were otherwise allowed as priority claims. Holders of gift card claims were required to file a gift card proof of claim no later than 60 days after the effective date of the Plan.⁵

Shortly after the filing of the Plan and disclosure statement, RadioShack found

itself as a defendant in two actions relating to RadioShack's proposed treatment of gift card claims under the Plan. The first action was filed by the State of Texas on behalf of Texas consumers; the second was filed by a purported gift card holder looking to commence a class action against RadioShack on behalf of all similarly-situated gift card holders.

The State of Texas Proceeding

On June 18, 2015, the State of Texas commenced an adversary proceeding⁶ against RadioShack arguing that, among other things, gift card claims should be entitled to priority as customer deposits pursuant to Section 507(a)(7) of the Bankruptcy Code. This section provides for priority payments of "allowed unsecured claims of individuals, to the extent of \$2,775 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided."⁷

In its complaint, the Texas Attorney General also argued that the value of the unused gift cards should be turned over to states, which would then be able to hold and process the claims for consumers. The State of Texas then filed a proof of claim on behalf of Texas consumers in an unliquidated amount. Numerous other states, including the State of New York, also filed proofs of claim on behalf of consumers relating to unredeemed gift cards.

In its response to the complaint, RadioShack argued that no gift card claims were entitled to priority and that no state has a valid claim to unclaimed property based on RadioShack's unredeemed gift cards.

Settlement of the Texas Adversary Proceeding

On September 16, 2015, the bankruptcy court entered an order approving a settlement with the State of Texas.⁸

Pursuant to the settlement agreement, claims by certain gift card holders, including those that were purchased by customers, will be given priority status and receive payment in full. Other gift card holders, such as those who received cards in promotions, will be treated as general unsecured claims. RadioShack, with the assistance of its financial advisor and gift card vendor, will be able to identify the type of gift card held by a holder based on the card's number. As a result, holders of unused RadioShack gift cards may receive payment in full or

may receive a much smaller distribution, all depending on the type of gift card that they hold.

The amended Plan will also double the time for filing gift card proofs of claim to 120 days after the effective date of the Plan, including the treatment of gift card claimants as set forth in the settlement. This was confirmed by the bankruptcy court on September 30, 2015.

The Class Action Proceeding

On July 17, 2015, RadioShack was hit with a class action complaint filed by Mark Haywood, a purported gift card holder. In the complaint Haywood sought a declaratory judgment that a class of gift card claimants should be formed and that the claims arising from gift cards should be entitled to priority pursuant to section 507(a)(7) of the Bankruptcy Code. RadioShack's opposition to the complaint argued that the plaintiff's motion for class certification should be denied as premature. Alternatively, RadioShack argued that the bankruptcy court should continue the motion for class certification until after the bankruptcy court ruled on the competing motions filed in the State of Texas proceeding.

On September 16, 2015, the same date that the bankruptcy court approved the settlement between RadioShack and the State of Texas, the bankruptcy court entered an order denying Haywood's motion for class certification.⁸

Going Forward

The treatment of gift cards in bankruptcy will vary from case to case. Whether the claims will be treated as priority claims or unsecured claims, the timing by which holders must file proofs of claim and the type of notice that must be provided to gift card holders, are just some of the questions that must be resolved in a retailer's bankruptcy case. These issues can also linger long after matters have purportedly been resolved.

Take the example of the Borders Group bankruptcy cases. In that case, the debtors treated holders of gift cards as unknown claimants entitled only to "constructive notice", i.e. notice by publication, of the bankruptcy and of the deadline to file claims. The publication did not mention gift cards, resulting in several holders of unredeemed gift cards filing late proofs of claim. The bankruptcy court denied their claims as untimely, and on appeal, the U.S. District Court for the Southern District of New York affirmed the bankruptcy court's ruling and dismissed the holders' claims as equitably moot. In October 2014, the



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U.S. Circuit Court of Appeals affirmed the District Court's ruling.⁹ The cardholders now are asking the United States Supreme Court to determine if their claims were improperly dismissed.¹⁰

In addition, federal legislation relating to the treatment of gift cards in bankruptcy proceedings may be enacted in the future. In November 2012, U.S. Senator Richard Blumenthal (D-Conn) sponsored the Gift Card Consumer Protection Act of 2012, a bill proposed to provide increased consumer protections for gift cards. The bill, if approved, would modify the Credit Card Accountability Responsibility and Disclosure Act of 2009 to prohibit a company that has filed for chapter 11 bankruptcy from selling or issuing gift cards and prohibiting any person from re-selling or re-issuing gift cards more than six days after the original issuer or seller has filed for bankruptcy. Moreover, it would require companies in bankruptcy to honor gift cards at full value, unless otherwise ordered by the court.

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1. See, e.g., *In re Ashley Stewart Holdings, Inc., et al.*, Case No. 14-14383 (Bankr. D.N.J.) (order authorizing the debtors to honor all outstanding gift cards, in an estimated value of \$1.4 million, in their ordinary course of business).
2. *In re RS Legacy Corp., et al.*, Case No. 15-10197.
3. *See Motion for an Order Authorizing the Debtors to (I) Maintain Certain Customer Programs and (II) Honor or Pay Related Prepetition Obligations to Their Customers* [ECF No. 7].
4. Docket No. 2404; Docket No. 2477
5. *See Joint Plan of Liquidation of RS Legacy Corporation and its Affiliated Debtors* [ECF No. 2538]
6. *State of Texas v. RS Legacy Corporation f/k/a RadioShack Corporation, et al.*, Adv. Pro. No. 15-50870.
7. *See Order Authorizing and Approving Settlement Among the Debtors, Creditors' Committee and the State of Texas and Disallowing Claims Asserted by States Related to Gift Cards* [ECF No. 2997].
8. *See Order Denying (I) Motion for Class Certification of RadioShack Gift Card Holders, and (II) Motion of Mark Haywood to Estimate and Temporarily Allow Claim* [ECF No. 2993].
9. *In re BGI Inc.; Beeman et al. v. BGI Creditors' Liquidating Trust et al.*, 772 F.3d 102 (2d Cir. 2014).
10. *Beeman et al. v. BGI Creditors' Liquidating Trust et al.*, No. 14-1527, petition for cert. filed (U.S. June 17, 2015).